



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
1100 Commerce Street
Dallas, TX 75242

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: December 10, 2009

Person to Contact:

Release Number: 201013075

Release Date: 4/2/10

LEGEND

ORG = ORGANIZATION NAME

XX = DATE

ADDRESS = ADDRESS

ORG

ADDRESS

Badge Number:

Contact Telephone Number:

Contact Address:

Employer Identification Number:

Deadline to Petition Tax Court:

CERTIFIED MAIL

UIL: 501.03-00

Dear

This is a final notice of adverse determination that your exempt status under section 501(c)(3) of the Internal Revenue Code is revoked. Recognition of your exemption under Internal Revenue Code section 501(c)(3) is revoked effective April 19, 20XX the following reason(s):

You are not organized and operated exclusively for an exempt purpose as required by Internal Revenue Code section 501(c)(3). You are not and have not been engaged primarily in activities which accomplish one or more exempt purposes. You are not a charitable organization within the meaning of Treasury Regulation 1.501(c)(3)-1(d); rather, your activities further a substantial nonexempt commercial purpose and serve private rather than public interests.

Contributions to your organization are no longer deductible effective April 19, 20XX.

Since your exempt status has been revoked, you are required to file Form 1120, U.S. Corporation Income Tax Return, for all years beginning on or after January 1, 20XX.

Income tax returns for subsequent years are to be filed with the appropriate Service Center identified in the instructions for those returns.

It is further determined that your failure to file a written appeal constitutes a failure to exhaust your available administrative remedies. However, if you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claims Court, or the district court of the United States for the District of Columbia before the (ninety-first) 91st day after the date that this determination was mailed to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment. To secure a petition form, write to the following address:

Please understand that filing a petition for a declaratory judgment under IRC section 7428 will not delay the processing of subsequent income tax returns and assessment of any taxes due.

The last day for filing a petition for declaratory judgment is March 10, 20XX.

You also have the right to contact the Office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers. You can call and ask for the Taxpayer Advocate assistance or you can contact the Advocate from the site where this issue was determined by writing to:

Taxpayer Advocate assistance cannot be used as substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determination, nor extend the time fixed by law that you have to file a petition in Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

This letter should be kept within your permanent records.

If you have any questions, please contact the person whose name and telephone number are shown above.

Sincerely,

Nanette M. Downing
Acting Director, EO Examinations

Enclosures:
Publication 892



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service
7850 SW 6th Court
Plantation, FL 33324

December 10, 2009

Taxpayer Identification Number:

Form:

ORG
ADDRESS

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Michael D. Glass
Group Manager

Enclosures:
Publication 892
Publication 3498
Report of Examination

The Examination of ORG

LEGEND

ORG = Organization name XX = Date City = city State = state
CPA = CPA Attorney = attorney President = President Secretary
= Secretary Vice President = Vice President DIR-1, DIR-2, DIR-3
= 1st director, 2nd Director & 3rd Director EMP-1 thru EMP-20 = 1st, 2nd,
3rd, 4th, 5th, 6th, 7th, 8th, 9th, 10th, 11th, 12th, 13th, 14th, 15th, 16th, 17th,
18th, 19th & 20th Employees CO-1 thru CO-29 = 1st, 2nd, 3rd, 4th, 5th, 6th,
7th, 8th, 9th, 10th, 11th, 12th, 13th, 14th, 15th, 16th, 17th, 18th, 19th, 20th,
21st, 22nd, 23rd, 24th, 25th, 26th, 27th, 28th & 29th Companies

FACTS

ORG (hereinafter referred to as either "ORG" or sometimes as the "organization") is a State not-for-profit corporation allegedly organized to provide educational services to the public. ORG filed Forms 990 (Information Return of an Organization Exempt from Income Tax under Section 501(c)) on a calendar year end for taxable years 20XX - 20XX (see attached Forms 990 as Exhibit 1).

On November 25, 20XX, January 9, 20XX, and January 23, 20XX, the Internal Revenue Service (hereinafter sometimes referred to as either "IRS" or "Service") issued a Letter of Examination for the year ended December 31, 20XX for the purpose of determining whether ORG is an organization exempt from income tax under I.R.C. § 501(c)(3) (see attached Exhibit 2). Attached to the examination letters were a detailed list of documents requested by the Service from ORG in order to commence the examination (see attached in Exhibit 2). At a later date the audit was expanded to include calendar year ended December 31, 20XX. During the course of its examination, the IRS issued one additional information document request (see attached listing of this request as Exhibit 3). Also, the IRS issued 3 summonses (see attached listing of summonses issued for ORG in Exhibit 4) and made contacts with former employees, officers/directors, vendors, regulatory authorities, and industry leaders (see attached listing of Third Party Contact list as Exhibit 5).

This report details the Service's findings resulting from its examination of ORG

TAX YEARS ENDING DECEMBER 31, 20XX, and 20XX

ISSUES PRESENTED:

1. Whether ORG operated exclusively for exempt purposes described within Internal Revenue Code section 501(c)(3):
 - a. Whether ORG engaged primarily in activities that accomplish an exempt purpose?
 - b. Whether more than an insubstantial part of ORG activities were in furtherance of a non-exempt purpose?
 - c. Whether any part of the net earnings of ORG inured to the benefit of any private shareholder or individual?
 - d. Whether ORG was operated for the purpose of serving private rather than public interests?

BACKGROUND INFORMATION

The Precursors to ORG: CO-1, President, the CO-2 and the Formation of "Clone" CO-1 Companies including ORG.

ORG was formed as a "clone" entity of CO-1, Inc. (sometimes referred to as "CO-1"), a credit counseling organization formed by President.¹ ORG was one of 11 "clones" of CO-1 formed between 19XX-20XX (see attached Exhibit 6 for the US Senate Report that illustrates the "CO-3," referred to in this Report as the CO-1 "clones"). All 11 of these entities were formed by family, friends, and/or business associates of President. As discussed in greater detail, *infra*, EMP-1, a former employee of CO-1 and President's brother, was instrumental in founding and operating ORG. CO-1 was the original company whose business model and practices were co-opted into "clone" organizations. The common operational element in CO-1 and its clones was the use of President's for-profit company, CO-2 (subsequently named CO-2 in 20XX) for back office service ("customer service") operations in which large amounts of fees were paid by CO-1 and its clones to CO-2. See the US Senate Report in Exhibit 6 and CO-1 Bankruptcy Examiner's Report in Exhibit 7.

When CO-1 was formed in 19XX, its mission allegedly was to provide credit counseling and educational services to consumers with debt problems. However, CO-1 quickly became involved in aggressively marketing to and establishing debt management plans² for consumers with credit card debt. Accordingly, CO-1's primary activity was the operation of a large call center in State (along with offices in State and in State, for a period of time) whose function was to enroll consumers in debt management plans. As a result of CO-1's aggressive advertising, large "lead" inventories were being generated by CO-1. ORG purchased surplus leads from CO-1.³ Due to the need to service the surplus, time-sensitive lead inventories, "clone" credit counseling organizations were formed by loyal, close business associates, friends and family of President. These loyal associates to President contracted each "clone" credit counsel agency (CCA), via Fulfillment Agreements, to have its back office services to be conducted by CO-2, President's for-profit company.⁴ Over 4 years, millions of

¹ President, a native of State and a graduate of the University of State, founded CO-1 through nominees, including his wife, EMP-2 and the wives of his friends/business associates. President controlled and participated in CO-1's activities in 19XX through 20XX. (See attached Exhibit 8, EMP-3's deposition (FTC) 01-06-20XX, pages 35, 36, and 72. See also Exhibit 9, EMP-3's deposition (FTC) -25-, pages 218 and 219. President, through his employment at and ownership in credit counseling and loan companies, had substantial experience in the debt consolidation industry. Many of his high school and college friends became his close business associates in virtually all of his endeavors including ORG.

² A debt management plan (sometimes referred to herein as a "DMP") is a tool used to restructure unsecured debt. Restructuring debt through a DMP allows a consumer to consolidate unsecured debt, ostensibly lower his interest rates and monthly payments, obtain re-aging of his debts, and/or curtail collections calls, penalties and over-limit fees. Typically under a DMP a consumer signed a contract agreeing to make monthly payments to the credit counseling organization, which then made arrangements with the consumer's end-creditors and distributed payments to them. CO-1, and the subsequent clone organizations including ORG, then charged consumers an initial "contribution" fee and monthly processing fees.

³ Leads are defined as information on a potential client who could enter into a debt management plan.

⁴ Initially, CO-1 used its own employees to conduct what can be referred to as "back office account management functions" which chiefly are administrative operations to implement and maintain payment processing and

dollars in fees were funneled to CO-2 (CO-3) by CO-1 and its clone CO-26 (see the Senate Report in Exhibit 6).

CO-1 and ORG executed separate Fulfillment Agreements with CO-3, whereby CO-3 provided back office administrative fulfillment functions in which CO-1, and eventually ORG also, paid substantial fees to CO-3 for these services.⁵ Accordingly, CO-2 handled all communications with consumers enrolled in DMPs and the consumers' creditors, including setting up repayment terms, fielding inquiries from the consumers, making outgoing calls to creditors, updating the consumer's information, collecting payments from the consumer (other than the initial "contribution" payment) and disbursing payments to creditors.

In addition to distributing payments to creditors, CO-3 solicited "fair share" contributions from credit card companies. The term "fair share" refers to a payment made by the credit card companies who are receiving payments pursuant to a DMP. Typically, credit card companies pay a fair share, which is a stated percentage of debt, to credit counseling organizations that set up DMPs; the amount paid is determined by each creditor in advance. Credit card companies generally will only make "fair share" payments to organizations recognized as exempt under section 501(c)(3) of the Internal Revenue Code. CO-2 collected and disbursed "fair share" payments to ORG.

As stated, the CO-1 business model was duplicated in "clone" credit counseling organizations with the assistance of CO-3, CO-1, and other President companies. Staff and documents from CO-1, CO-16t-up loans from President's company, CO-4, and DMP leads from CO-3, were co-opted to CO-16t ORG.

ORG Historical Corporate Information

ORG was formed on April 19, 20XX, as a non-for-profit corporation in the State of State. (see the Articles of Incorporation attached as Exhibit 12). The Articles of Incorporation assert that the organization's purpose is "To assist needy debtors to improve their finances through educating them as to better means of managing their money and through seeking for them, if appropriate, an extension or other reorganization of their debts."

On June 15, 20XX, ORG submitted a Form 1023, Application for Recognition of Exemption under section 501(c)(3) of the Internal Revenue Code, to the IRS. The Form 1023 bears the signature of EMP-1 as President of the organization. (see the attached complete Form 1023 with all attachments as Exhibit 13). The organization was granted exemption from Federal income tax by the IRS under the provisions of I.R.C. section 501(c)(3) by a letter dated August 16, 20XX.

Form 1023 Application Representations

accounting and negotiations with creditors for consumers on a DMP. However, in 19XX, less than three years after CO-1 commenced operations, President incorporated a wholly-owned for-profit corporation, CO-2, Inc. (sometimes referred to as "CO-2" or "CO-3") and CO-1's back office account management functions were transferred to CO-3 pursuant to an Asset Purchase Agreement.

⁵ CO-1 and ORG Fulfillment Agreement terms are similar, if not exact (see CO-1 Fulfillment Agreements from the Federal Trade Commission files in Exhibit 10 and the ORG Fulfillment Agreements with CO-2/CO-2 in Exhibit 11).

In the Form 1023 application, Part II, line 1, ORG stated that it was formed to help reduce personal bankruptcy by (i) educating the public about personal money management skills and (ii) assisting needy individuals and families with their financial problems. To accomplish these objectives, ORG indicated in its Form 1023 Application that it planned to engage in three main activities.

Asserted Activity 1: Public Information. According to statements made in the Form 1023 Application, ORG planned to prepare videos, pamphlets, and other educational materials on budget, buying practices, and the sound use of consumer credit and to disseminate this information to the general public. These materials were to be provided free of charge to religious organizations, civic groups, labor unions, businesses, and educational organizations. In addition to the provision of educational materials, the Form 1023 also indicated that ORG planned to conduct financial planning workshops by providing knowledgeable speakers free of charge to these groups. According to its Form 1023 Application, ORG principal CO-8s for this activity would be lower-to-middle income families. After the first year, the organization expected this activity to comprise 20% of its time.

Asserted Activity 2: Counseling. The 1023 Application further states that trained "financial counselors" would provide personal financial counseling on budgeting and the appropriate use of consumer credit to consumers. According to the Application, these individuals would also receive copies of the public information discussed above. ORG indicated that it expected a substantial number of its clients to be low-income referred to them from clergy, employers, labor unions, creditors, finance companies, and creditors. The organization stated that after the first year it expected that this activity would constitute approximately 60% of its time.

Asserted Activity 3: Budget Plan. The third activity described in the Form 1023 Application was making a budget plan available to its clients. The activity was described as follows "As part of the counseling program, clients will receive information about the availability from ORG of budget plan services." Under the program, ORG indicated that it would intercede with creditors in order to persuade them to accept partial periodic payments. According to the Form 1023, the clients would make fixed monthly payments to ORG who, in turn, would disburse these funds to the creditors. ORG indicated that the clients would be requested to pay periodic fees to ORG for the budget plan service. "The fees will consist of \$ per creditor per month up to a maximum monthly fee of \$ per client. These fees will be reduced or waived for any client who is financially unable to pay the full amounts." The organization indicated that a maximum of 20% or less of its "counselors" time would be devoted to budget plan preparation.

Expected Source of Funding:

According to the Form 1023 Application, ORG expected that more than 90% of its revenues were to come from "contributions" primarily from creditors participating in the budget plans and from clients, with some contributions coming from religious groups, civic groups, labor unions, businesses, and educational organizations who would be participating in the public information activities. ORG expected that approximately half of all creditors to make a fair share "contribution" of 5%-15% of each monthly payment. According to the Form 1023 Application, ORG anticipates receiving substantial "contributions" from clients. According to Part II, Line 2, of the Form 1023 Application, "ORG will ask clients to help defray the costs of its counseling and budget plan cost through a payment of 2½% of their outstanding indebtedness." According to ORG, the payment was

to be strictly voluntary and no one would be denied service for failing to make a contribution. ORG expected that 75% of clients would make some contributions.

According to the Form 1023 Application, ORG anticipated receiving revenues in the form of fees to be charged to "financially able clients who participate in the budget planning program." It represented that the fees would consist of \$ per month per creditor per client to a maximum of \$ per month. ORG indicated that these fees would be reduced or waived for indigent clients and that no client will be denied budget plan service due to an inability to pay any fees. It expected that 10% of ORG revenues will come from these client fees. ORG indicated that the balance of its revenue "less than 19%" of total revenue would come from investment and interest income.

Expected Source of Clients and Criteria for Participation:

According to the Form 1023 Application Part II line 1, ORG stated that in order to built its clientele, it would place advertisements in the electronic and print media. It also planned to obtain clients from its financial and budgeting workshops to be provided to religious organizations, civic groups, labor unions and businesses. These groups were expected to publicize the workshops to its members through fliers and other regular membership mailings. Page 5 of the supplemental information stated that ORG would conduct periodic mailings to community groups that were likely to encounter debtors in need of financial assistance. According to the Form 1023 Application, ORG also stated that it would assembled a group mailing from telephone and other directories of organizations located in the Nassau and Suffolk County areas of State. ORG stated that referrals to its program was likely to be made from clergy, employers, labor unions, finance companies, creditors, and interested individuals. ORG expects that a substantial percentage of the referrals and those attracted by media advertisement would be low-income persons with some moderate income persons.

Form 1023 Filing:

The Form 1023 Application Package was prepared and filed by ORG's attorney, Attorney. ORG consented via Form 2848, Power of Attorney, to have Attorney represent ORG in its filings with the Service (see attached Exhibit 14). Attorney handled the entire incorporation and exemption application process for ORG (see attached Exhibit 15 detailing the letters and representation by Attorney to the IRS).

Because ORG received an "advance ruling" under sections 501(c) (3) and 509(a) (2) as a publicly supported organization, it filed a Form 872-C, Consent Fixing Period of Limitation Upon Assessment of Tax Under Section 4940 of the I.R.C., which allows the IRS to solicit information on public support and determine if ORG meets the qualifications of a non-private foundation under section 509(a) (2). The Form 872-C bears the signature of EMP-1, as President of ORG. (see attached Exhibit 16).

The Examination of ORG's Activities; ORG Board members, Officers, Directors and Board Minutes

Forms 990:

Form 886-A, Examination Report of ORG (attached to 30-day Letter)

Per the information set forth on the Forms 990 filed with the IRS since inception, the individuals who have served as the Directors and Officers of ORG are as follows (See attached Part V of Forms 990 for 20XX-20XX in Exhibit 17):

20XX:

EMP-1, President

20XX:

EMP-1, President

Vice President, Vice-President

Secretary, Secretary

Key Employees and Founder:

EMP-1 (hereinafter "EMP-1") was the founder of ORG and the brother of President (see EMP-1 interview Exhibit 18). According to EMP-1, he began working for President in 19XX as a counselor at CO-5 (CO-5). CO-5 was a for-profit company owned and operated by President. In 19XX, EMP-1 began working as an employee of CO-1 where he worked as a counselor.

The formation of ORG resulted from the closure of one of CO-1's offices that was located in State and operated by EMP-1. Since the CO-1 State office was closing, EMP-1 formed ORG and acquired CO-1's assets of computers, cubicles, and office equipments via an asset purchase agreement. ORG engaged the same attorney as CO-1, Attorney, who prepared and filed ORG's Articles of Incorporation on April 19, 20XX with the State of State Division of Corporations (see attached Exhibit 12). In addition, ORG hired several of CO-1's employees and continued to conduct the activities that CO-1 had been conducting.

EMP-1 received a loan from CO-4 (IRG) to assist with CO-16t up costs in the amount of \$ (see attached Exhibit 19 for copy of note). EMP-1 was also a former employee of IRG, a for-profit company owned and operated by President (see attached Exhibit 18 for copy of Interview with EMP-1 President).

ORG Corporate Minutes:

No minutes were provided for 20XX. A summary of ORG's corporate minutes from July 20XX – November 20XX disclose the following. (see attached Exhibit 20). July 16, 20XX written consent in lieu of organizational meeting of all the directors the following directors were elected - DIR-1 and DIR-2 October 3, 20XX written consent in lieu of organizational meeting of all the directors:

- The following directors were elected - DIR-3 and Secretary. October 5th, 20XX written consent in lieu of organizational meeting of all the directors
- The following were elected officers of the corporation - DIR-3 – Vice President, and Secretary - Secretary

November 29, 20XX written consent in lieu of organizational meeting of all the directors.

- New Accountants – discussion pertaining to replacing the current accounting firm of CO-6 with new accounting firm located in the state of State. CPA, the controller, to be responsible for researching and hiring this new firm. EMP-1, DIR-3, and Secretary voted in favor.

Board Members Involvement

EMP-1 explained during the interview that both CPA and Secretary were asked to be on the board because they were childhood friends and they were interested in the business.

According to President there were only three people on the board - CPA, Secretary and himself. The board members were to serve until they resigned or were re-appointed. Eventually, both CPA and Secretary resigned and CO-16 their own credit counseling companies. They were replaced by DIR-2, and DIR-1 who were seasonal employees of ORG. Both were in the landscaping, bait and tackle business prior to becoming counselors.

Per EMP-1, he made the day to day business decisions for the company. He stated that the board did not have any formal meetings. (see EMP-1 President interview Exhibit 18)

Advertising, Marketing and Solicitation Activities Identified During Examination

ORG was extensively involved in soliciting consumers via telephone to participate in its debt management program or debt management plan (hereinafter "DMPs"). A debt management plan or "DMP," which was only available to individuals with unsecured debt, allowed a consumer to make one consolidated monthly payment to ORG for disbursement to the consumer's various creditors. Most creditors generally offer reduced interest rates to consumers who pay through a debt management program.

An example of how a typical DMP in the year 20XX worked is as follows: The consumer has 4 creditors. The consumer's proposed monthly payment is \$, computed based on debt load and guidelines established by the creditors. The \$ is the monthly amount that will be disbursed to the creditors. In addition to the amount for disbursement to the creditors, the consumer pays a monthly fee of \$ for a total monthly payment of \$. According to the DMP agreement the client agree to "make a voluntary "monthly" contribution of \$ per account that ORG is handling". Thus, for this example, the monthly contribution is computed as follows: 4 creditor payments processed per month at \$ each (4 x \$ = \$ Monthly Consumer Processing Fee). The consumer is also charged a one-time "contribution" of \$. The one-time "contribution" amount is equivalent to one of the consumer's monthly payment including the monthly processing fee. ORG keeps the one-time "contribution" and all subsequent monthly processing fees. (see attached Exhibit 21 for a copy of the Client Information Sheet).

Based on records and information provided by ORG, records provided by third parties, and interviews conducted with third parties, ORG engaged in a number of advertising and marketing activities during the years 20XX and 20XX. Specifically, ORG utilized radio and internet ads to advertise its services. ORG's clients were primarily procured through the process of lead generation. A lead is a consumer response to an advertisement or promotion in which the consumer has provided a name, address, phone number, and has a minimum of \$ in unsecured debt. See attached Exhibit 22

for Letter from CO-7 which includes a definition of what constitutes a qualifying lead. The leads were then used by ORG "counselors," hereinafter referred to as employees, to contact the consumers with regards to ORG's services.

ORG outsourced most of its advertising functions relative to radio, and internet advertisements to CO-7, a for-profit company owned by EMP-4, also known as EMP-4. In addition to CO-7, ORG also used other vendors whose advertising services were procured through CO-7. Through these vendors, ORG used radio stations, to conduct advertising campaigns. The radio stations were given copies of ORG scripts for advertisement purposes.

Indicated below is a summary of its advertising/marketing activities used to promote its services: Per CO-7 letter dated December 13, 20XX, in 20XX, ORG conducted a Radio campaign with CO-8 and Response to advertise its services. In 20XX, CO-7 conducted an internet ad campaign for ORG with CO-18 (see attached Exhibit 22).

Radio. In 20XX, ORG entered into a contract with CO-8 and Response for advertising purposes. According to the agreement, CO-8 and Response would provide ORG "exclusive direct marketing radio advertising service using radio stations, networks, and other radio programming services." ORG was billed for each billable inquiry defined as any caller with a minimum of \$ of unsecured debt who requested information from ORG and provide a valid name, address, and phone number (see Exhibit 23 for copies of leads/advertising agreements).

An example of a 60 second radio spot for ORG on a script dated 8/9/XX (see attached as Exhibit 24), consisted of the following:

"Do you find yourself "just another day older, and deeper in debt?" Whether you're twenty-something and owe credit card bills or college loans, or you're a senior citizen overwhelmed by medical bills, there's help at hand. Just call ORG at 1-800-_____. ORG is a non-profit credit counseling organization that offers help for consumers, like you, who are ready to eliminate their debt. If you owe creditors over two-thousand dollars, just call ORG and they can help end harassing phone calls by creditors. They can help you pay off your bills in as little as one-quarter of the time you normally could. Even reduce your monthly payments as much as 50-percent and consolidate them into just one, manageable payment a month.

Another example of a 60 second radio spot with airdates of 12/31/XX – 2/10/XX is as follows: "Are you scared of how in-debt you are? If your New Year's resolution is to get out of debt once and for all, now there's somewhere you can turn for help. It's a non-profit organization called ORG. They'll negotiate with your creditors for you. They can get your payments reduced as much as 50-percent, eliminate or reduce your interest rates, and much more. Just call 1-800-_____ to see what ORG can do for you. Even if you're not a homeowner, ORG can help. They can consolidate your multiple payments into one, lower monthly payment. And with their help, you can pay off your debts in as little as one quarter of the time you'd be able to on your own. If you have over two-thousand dollars in bills, call ORG now for a free debt consolidation – 1-800-_____. It's completely confidential and there's no obligation." (see Exhibit 24 for copies of scripts for advertisements and internet banners).

Publications ORG also generated leads by placing advertisements in the classified section of various publications such as CO-9, CO-10, CO-11, CO-12, CO-13, CO-16, CO-14, and CO-15. An example of a standard advertisement taken from the CO-17, read as follows:

“DEBT CONSOLIDATION
Regain control of your families finances!
➤ Reduce Payments Dramatically
➤ Reduce Interest Rates
➤ No Credit Check
➤ Home Ownership Not Required
Free Consultation. Non-profit Organization

(See Exhibit 25 for a list of printed advertisements and for examples of advertisements that were placed in various publications).

Internet Campaigns: In 20XX, CO-7 also generated leads for ORG by conducting an internet advertising campaign with CO-18 for ORG. The campaign featured a banner advertisement on the internet on a cost-per-click basis. According to CO-7, the advertisements that ran on the internet were banner advertisements that linked consumers who clicked on the banner to ORG’s website. As described in a memo dated December 13, 20XX, the advertisements were “simple text ads that cycled through two or three panels that said something like: “Got Debt?/We Can Help/Get out of Debt Now- ORG Click Here.” (See Exhibit 22 for copy of CO-7’s letter).

For example one banner showed the following information. “ORG MILLIONS of people in the U.S. are stuck in DEBT! If you’re one of them, we can HELP! Lower monthly payments Reduce Interest One monthly payment Non-profit”

Another example was as follows:

U.S. O N L Y
ORG
A non-profit organization

- ✓ Make one small monthly payment
- ✓ Improve your credit rating
- ✓ Consolidate your bills

(See attached Exhibit 25 for a copy of the print advertisement).

ORG also purchased leads from various lead generation companies that generated leads through a series of campaigns done via the internet. The campaign primarily consisted of advertisement banners placed on various websites to attract individuals interested in debt consolidation. By clicking on the banners, the consumer was provided a form to provide information such as name, amount of debt, etc. Lead generation companies generally sell such leads on the market to buyers. ORG purchased leads from several lead generation companies such as CO-19 CO-20 CO-21 (see Exhibit 26 for copies of lead agreements).

According to the Adjusted Trial Balance for period ended December 31, 20XX, ORG paid a total of \$ for advertising and leads which represented approximately 28% of ORG's total expenditures. (see Exhibit 27 for copy of Adjusted Trial Balance - accounts 69001 Adv Exp & 69005 lead source exp).

Enrollment of Consumers in DMPs by ORG's Employees

Employees' Qualifications and Training. Leads that were acquired were distributed to ORG's employees for phone contact with the consumers. ORG failed to provide us with copies of position description requested in a summons issued on June 20XX which would have provided information on the qualifications and responsibilities of the employees who were responsible for interacting with the consumers. However, copies of classified advertisements for such workers were secured and provided the basis for our determination of the employees' duties and qualifications. The following advertisement was noted in the CO-22 dated June 18, 20XX. (See Exhibit 28 for copies of classified advertisements and invoices).

"INSIDE SALES

High Income/Potential

Stock Broker/Collection Experience A Plus

No Cold Calls, Leads Provided, Paid Training, Full Medical

Another classified read as follows:

"ABC

ALWAYS BE CLOSING

\$k + Pot'l Top Comm paid + Bonus.

Free Leads, no cold calling. Full bnfts, City location

In the personnel file for EMP-5 was a form titled "Potential Interview Questions" which listed several questions used by ORG to screen potential employees for "counseling" positions. (See Exhibit 29 for a copy of EMP-5 personnel file). The questions include the following: a) "Do you have any prior sales experience?" b) "Do you have experience with phone sales?"

No minimum level of education was required for applicants to be hired. No certification, license, or prior experience in the field of counseling was required.

In response to IDR DEB-001, ORG provided us with a copies of information used in its training sessions. A copy of their training manual was also received from State of State Banking Department (see Exhibit 30 for copies of training materials). The information consists of the following materials listed by title:

1. Who does or does not qualify for the program - States that client must be able to afford the minimum monthly payment; pay at least 2% of their outstanding debt; must be having difficulties with their current monthly bills; must have desire to get themselves out of debt. The page also provides a list of the types of accounts the ORG could or could not handle.
2. Qualifying your new client: A page consisting of a series of qualifying questions that employees were to ask each consumer. The questions include the following "What type of bills do you want to consolidate?", "Are you current or falling behind?" In what appears to be an earlier

version of this script which was received from State Banking Dept. Exhibit 30, the following paragraph appeared before the qualifying questions "These [qualifying questions] should be asked to each client before giving your sales presentation, they will allow you to determine the clients wants, needs and hot buttons. Take advantage of their responses by writing the answers down on the application. If you don't know exactly what the client wants to do its harder to close the deal.

***Once you've determined the clients wants and needs customize your presentation to fit their needs.*"**

3. New Client Enrollment Process: Provide a list of the steps involved in enrolling the clients in a DMP

4. Initial contact with client: Provides information on how to leave a proper message for a consumer. An example of the message was provided.

5. New Account Presentation: Consist of the presentation script which is the primary script used by the employees to interact with the consumer. This script was previously titled "Initial Sales Presentation" (copy received from State Banking Dept. - included in Exhibit 30). The introduction paragraph for this script was as follows: "Before you try to sell a new account you first must know what the client wants to do. If you spent the time to **qualify** your applicant then you already know what their hot buttons are and you can continue. Never become generic with your presentation, use the client's hot buttons and customize your presentation to fit their needs."

6. Program Benefits: Listed the benefits of the program. Such include a) one lower monthly payment b) Reduction in interest c) Improve credit d) Late and over the limit fees stopped e) End to creditor harassment f) Convenience of only one monthly payment. In an earlier version of this script, received from State Banking Dept., the following introduction paragraph appeared "ORG, Inc is the **ONLY** company in the country that offers such a unique and beneficial debt consolidation program. Our **"six-month"** program has revolutionized the debt consolidation industry by providing clients with the **benefits associated with working with a non-profit credit counseling company, combined with the opportunity for a complete debt consolidation loan.** There is no other company or program available that can provide you with both these benefits, and we are certain that once you begin working with ORG you will be as excited as we are about our revolutionary debt consolidation concept."

7. Sending out agreements: Listed the various methods used to send out the agreements, as well as the pros and cons of each. The methods included facsimile, ORG website, and through the mail. Also provided was a list of rebuttals to encourage consumers to use the fax method which was ORG most preferred method of sending out the agreements.

8. Tips for getting contracts back: [State Banking Dept copy included in Exhibit 30]: Emphasized to employees the necessity to persistently continue to call a client back until they actually get to speak with the client. Employees are reminded to use the clients' hot buttons in order to get them to return the completed forms. Several scripted paragraphs are also presented that could be used to convinced consumers to return the paperwork.

9. Helping a Client Join: Include the following - Provides hints on how to deal with the creditors that the consumer have referred to ORG to prevent a potential client from being scared by

the creditor into not joining the program. Techniques involving follow-up with consumers. A series of questions and answers to respond to potential questions posed by the consumer. For example, What happens if the creditors do not accept my proposal?; Is bankruptcy an option for me?; and Why do I still get letters from my creditors?

10. Preparing a quote {State Banking Dept. copy included in Exhibit 30] - Instructs employees to calculate the consumer's monthly payment before calling consumer. Instructs employees to review the creditor information page and compare the accounts with the program benefits book to obtain monthly payment. Also instructs employees to include monthly fee, proposal enhancement to compute the monthly payment.
11. How to Solidify a Deal: Provides the information on how to interact with the consumer after the enrollment forms have been returned. Provides an example on how to handle the conversation with the consumer to ultimately receive a commitment of a payment date within the shortest time frame, as well as to get the consumer to make the payment from their account on the phone or via Western Union.
12. Creditor Relations: Provides information on how to win the creditors' trust, and how to handle unfriendly creditors, and collection agencies.
13. Verifying Receipt of Payment: Advised employees to daily check the payment list to verify consumer payment.
14. Sending an account to Client Services: Instruction to contact consumer to verify payment date, and procedural instructions to forward the file to Client Services (CO-2).
15. Points to Cover: Listed areas to address with consumers once the payment is received. It includes setting up second payment date; inform consumer about the introduction package that will be mailed; introduction package provides additional instruction about the debt management program; and the process of issuing proposals to the creditors.
16. Several pages of information sent to the consumer which appears to be a part of the introduction package. Consist of several reminders regarding actions that are required to be taken by the consumer and other information about the debt management program.
17. How to handle clients that are already on the program.
18. Questions and Answers: Script consisting of a series of questions and answers for employees to use while interacting with the consumer.
19. A copy of the package that is faxed to the consumer which includes the agreement, and a list of the benefits of the debt management plan.

Along with the New Account Presentation script, the employees were trained to use other scripts to address various situations they may encounter during the process of convincing the consumer to enroll in the debt management program. For example, the script titled "Questions and Answers"

provided several questions and answers scenarios for employees to use during contact with a consumer. It includes some of the following:

"How do I know that your company is legitimate?" Response: "We are a Federally approved not for profit organization and are under strict guidelines. We have a great relationship with many creditors who will verify our company. Once you complete the paperwork and before you send any money, I will ask you to refer any creditors' calls to me."

"It sounds great and I can make my first payment in 30 days from today." Response: "Unfortunately there is no way for me to keep your creditors satisfied and not send out proposals for 30 days. If you cannot make a payment sooner, I am going to have a difficult time assisting you and the interest will keep piling up."

"Isn't this the same as bankruptcy?" Response: "The program has nothing to do with bankruptcy. The creditors would not accept the terms of the program if they thought that it was derogatory. They would not give better repayment benefits if they did not support clients who go through our program."

"I am going with another company that doesn't charge any fees." Response: "I realize that we are not the only game in town, and every company has to charge something. Don't forget that your credit is an important part of your life and if the program is not handled properly your credit could be damaged and you will be wasting money on interest and late fees. Every penny we take in gets re-invested back into our company to give you the best all around service. Our client service department is second to none and is properly staffed to give you and your creditors the best service. Since we are a not a for profit organization any contribution becomes tax deductible for you anyhow."

Tips for getting contracts back: "We are a federally approved not for profit agency, they do not just give that title to anyone, the company's background was researched extensively before we got our approval. If we were in business and "ripping people off" there would be complaints filed against our company and then we would lose our not for profit listing. If we were not a not for profit the creditors would not cooperate with us and therefore would be out of business, it's a good system of checks and balances in place for your protection."

"I cannot afford a contribution right now, but maybe I can afford to contribute later." Response: "If you can afford to make a monthly payment, you can afford to make a contribution because of the 30-day negotiation period. As long as the creditor receives a proposal they will know of your intent to get out of debt, and they will not expect any payment until the negotiation period is complete. You may fall a little further behind by supporting this program but as long as you make all your payments on time your accounts should be re-aged. That contribution is not going into our pockets, it is going towards setting you up on the program (Explain all the departments that are involved). Would you rather have that payment go to us to help people like you out of debt or would you like it to go into the creditors' pocket as extra interest because many of your accounts will not re-age until after 3 months (Go over interest charts and savings with them). Without the contributions from our clients we could not stay in business. Would you rather support a non-profit company or help a bank get richer."

Several questionnaires were sent by the Service to former employees to obtain information which includes information regarding the initial training they received. In response to question 6 in the questionnaire "What type of initial training did you receive from ORG? Some of the responses were as follows:

EMP-6 response: - "Script learning" (see Exhibit 31 for EMP-6 questionnaire response).

EMP-7 response: "A week of class training a week of listening to another counselor". (see Exhibit 32 for questionnaire response from D.E. S.).

EMP-8 response: "Trained with other counselors, listened in on phone calls to understand customers questions + concerns." (see Exhibit 33 for questionnaire response for EMP-8).

Employees' Compensation In response to IDR DEB-001, question 17, ORG described its compensation arrangements as follows "In order to reward employees for hard work we paid bonuses to counselors based on the number of consumers they assisted in joining the credit-counseling program. We felt that by paying employees a lower base pay with incentives, consumers received more attention from the counselors. Managers were compensated with bonuses based on their team's performance. In all cases the bonus program was not only based on client enrolment but also on client satisfaction. Bonuses would be withheld if it were found the counselor/manager was not assisting already enrolled consumers."

(see Exhibit 34 for copy of IDR response).

Employees were required to sign a "Sales Performance Agreement" at the time of employment. The agreement states the following:

"I acknowledge that at the time of my hire I was made aware of the salary ranges that are commensurate with account achievements. I do understand that if I attain a certain salary range and then fall below the standards to maintain that range, management has the right to reduce my salary to the appropriate salary range based on my performance. I understand that upward and downward mobility with regard to salary is based on the consistency with respect to the total number of monthly accounts that I achieve. I understand that the purpose of this procedure is to provide flexibility with regard to compensation and salary according to my production achievements. I also understand that management reserves the right to base salary adjustments on not only the quantity of my work but also the quality. I understand that poor work quality can result in salary reduction as well." (see Exhibit 53 for a copy of this agreement).

A review of several personnel files for the 20XX tax year showed salary adjustments based on number of enrolled clients and total "contributions" received by the employee. For example, personnel file for EMP-1. (see attached Exhibit 36). showed that he received a salary increase of \$ on May 1, 20XX. The explanation provided as the reason for the increase/decrease was the showing of a listing of monthly total enrollments and contribution from February to March.

In the personnel file for EMP-13 [see attached Exhibit 37] his payroll increase form dated 11/22/XX showed an increase salary from \$ to \$. The reason for the increase was stated as follows: "promoted to Manager as of Dec 1, 20XX. 1.5% on each team member above 30 accounts. 5% of each blow

out received." **"*Will be reviewed every 3 months for increase or decrease on salary* Increases based on team performance # of house accounts and blow-ins and assists."**

The following Commission Schedule located in the personnel file for EMP-9 (see attached Exhibit 38) provides an overview of one of ORG incentive programs to compensate employees. Excerpts from the memo which bears the signature of EMP-9 and dated 12/12/XX state the following:

"Those on draw versus commission (25%) will have their second or third check of the month adjusted based on the previous month's sales. The first draw of the month will be your current rate of pay. After the draw has been deducted from your prior months commission, the second pay will be the difference. If your 25% commission is higher than your draw, you will receive your normal draw on the second pay and an additional check for the difference, which will be taxed at four weeks. However, the reverse is true if your commission is not enough to cover your draw. Any shortage will be deducted from the second check of the month or carried to the next month when appropriate. The third check will be adjusted in the three-month pay situation. In three-pay months, you may find yourself in a negative situation, which means you may not draw a check on the third payday. Management reserves the right to adjust your draw amount based on your sales performance for the preceding month if it is felt that your draw has been exceeding your sales."

According to the computations in EMP-2. file for the months of October 20XX to December, his compensation was twenty-five (25%) the total amount of "contributions" that he brought in for the month. For example in October 20XX, he brought in a total of 44 clients for a total "contribution" of \$. His compensation for that month was computed at \$ (Total "contribution" of \$ x 25%). [See Exhibit 38 for October 20XX calculated compensation].

Included in the personnel file for EMP-10 as a payroll status change from "counselor" to manager. His new compensation was stated as follows "K a year + \$ for every counselor over 30 accounts." (see Exhibit 39 for copy of EMP-10 personnel file).

Thus based on information in employees' personnel file, employees' compensation was based on the number of enrolled clients and the amount of "contributions" that the employee brought in.

From the personnel file of EMP-12 the following comment was noted on the Employee Termination Form dated 12/16/XX (see Exhibit 40).

"EMP-11 could not close an adequate amount of accts each month"

Employee Telephone Sessions with Consumers. ORG operated a call center staffed with employees whose only responsibility was to enroll consumers into ORG debt management program. Primarily all of ORG initial contacts with consumers were done via telephone. Per employee's response to questionnaires (question 20), each employee was expected to make 100 calls per day (see Exhibit 32 EMP-7 response & Exhibit 41 for EMP-13 response). Per EMP-13 in response to questions 17 and 18, the average length of time for initial phone call with a consumer was 10 minutes and manager's expectation was 10 to 20 minutes.

According to an email from CO-23 dated 12/19/20XX (see Exhibit 26), residents from State, State, State, State, and State could not apply for DMP with ORG. Thus it appears that in 20XX ORG conducted business in at least 45 States.

In response to IDR DEB-001, question 20, ORG provided various scripts, used by its employees during phone contact with consumers. The scripts were a part of the training package and are included in Exhibit 30. The process of enrolling a consumer in a DMP was listed by ORG as follows:

Make initial contact with client Proper introduction Qualify your potential client Explain program benefit concentrating on the clients' goals Disclose contributions Give examples of savings
Go over goals with client Arrange to have paper work sent out Explain necessary steps about returning information Answer any questions Get commitment from client about returning information for quote Confirm fax numbers before handing to administrators (see Exhibit 30) for page titled "Initial Presentation (Simplified)"

The process listed above described all aspects of the interaction that occurs between the employee and the consumer from the initial contact to the consumer being enrolled in the DMP. The employees first introduced themselves to the consumer by providing their names and the name of the company from which they are calling. Immediately after the introduction, the employee then begins the qualifying process by asking the following question from the New Account Presentation script:

"What types of bill are they?"

"Are you current or falling behind?" The note in the script states that if a client is current and making the minimum payments plus, or only has secured debt the employee was to explain that ORG services would not be a benefit to them and to end the call.

"How high are the interest rates?"

"Are you still using the accounts?"

"What are your goals when consolidating?"

If the consumer qualifies by having unsecured debt of at least \$ and is falling behind in his or her payments the counselor would read the following from the scripts: "Okay, from what you've told me so far I think I can definitely help you. Please grab a pen and paper and write down my name and number."

The employee would then explained the program reading from the script: "What we do is take all of your bills and put them into one easy monthly payment, because we are not for profit organization and have a special relationship built with your creditors, we should be able to lower that payment anywhere from 30-50%. Because of that lower payment you will be left with a lot more money after paying your bills. More importantly we can lower your interest rates from the usual 24% average down to hopefully a 0 to 10% average, this way you are paying your principal balance not the interest and will pay the debt back a lot faster with less money. Your creditors may also waive any late or over the limit charges that may be adding to your balance each month and if you're past due they may bring your accounts current without you making up the past due amount."

The employee still reading from the script would inform the consumer that paying their bills off on their own would take between 20-30 years but by having their interest rate lowered their bills should be paid off in 3 to 5 years.

In the script obtained from State Banking Dept., employees also informed the consumers of the following: "Also, we work with a network of lenders that may be willing to lend you money considering you can meet their criteria and make your payments on time each month 7 times in a row. If you do get approved for a loan the lenders can negotiate a settlement with your creditors anywhere from 50 to 75 cents on the dollar saving you even more money."

The employee then provides information about any fees charged: "Since we are a not for profit company we do not charge any fees for the service we provide. We do accept voluntary contributions from our clients and sometimes their creditors to help offset the cost of administering the program. We will ask for a contribution equivalent to your first payment on the program and 6 dollars for each account we service monthly but will still assist you if you do not contribute. Please understand that the money will (we) collect is used to provide you with the best service we can and if nobody were willing to contribute it would be difficult for us to provide the service we do."

It appears that employee faxed a total of eight pages to the consumer for completion. The New Account Presentation script state the following "I will have my administrators fax you a total of 8 pages you only have to fill out 4 of the 8. The first page is an agreement that will verify our not for profit status. In the agreement it will state that we ask for 6 dollars for each account for administrative costs, it will also state tat we ask that your first payment go to our company for setting up your accounts. Every payment thereafter will go to your creditors at the benefits we can provide. The next page is an authorization to release information form. This form gives us permission to speak with your creditors. The third page is a creditor list where you list who you owe and how much you owe them." "The last page is a budget worksheet where you list all of your expenses."

Thus upon completion of the call the employee faxed several pages to the consumers with instructions to return pages 5, 6, 7, 8. Page 1 - Fax cover page, Page 2 - a thank you letter for applying to ORG. The letter instructs the consumer to complete the forms and send them back and by doing that they are allowing ORG to provide a free evaluation of their financial situation and to determine their monthly payment and interest reduction. Page 3 - benefits that the program provides; Page 4 & 5 - Consumer Agreement; Page 6 - Authorization to Release Information; Page 7 - Creditor Information Sheet; and page 8 ORG Budget Worksheet. The four pages to be completed and returned were the following: - a) The last page of the agreement b) Authorization to release information c) Creditor Information Sheet (list of bills for the program) d) a budget worksheet

The instructions regarding sending out agreements instructs the employee to refrain from using the mail and to persist and push for the other options which is primarily to have the consumer locate a fax where they can pick up the information and faxed it back to the employee. Consumers were asked to check their phone book for a convenient location offering facsimile transmission. They were asked about checking with their boss, family member, or friend for a fax machine. They were told that "By the time you receive the mail accounts will be even further behind. Don't forget: interest never sleeps. If you want me to get you the program benefits you have to get me the agreement and creditor info pages and the mail is going to slow you down."

Employees were trained to persistently call the consumer to get them to return the contract. According to one of the paragraphs in "Tips for getting contracts back" - "After you do get in touch with the client always **assume the sale**. Ask them if they have any questions and be sure to address any concerns they may have. If they have no questions get the commitment from them when they can return the fax back, **not for your benefit but to help them accomplish their goals (remind them of their hot buttons.)**" In another tip employees were instructed that **"If the client does not want to join you have to again go over their hot buttons and remind them of the benefits of the program."**

Once the information was received the employee used a script titled "How to Solidify a Deal" to continue with the enrollment process. The importance of this script is underscored by the introduction paragraph of the script which states "One of the most important conversations you are going to have with your client is after the fax comes back. At that time you have to put on your best show and convince the client to continue with the plan." Upon receipt of the fax, the employees were instructed to look over the account to remind themselves of the consumer's goals (hot buttons) and to take notice of the reduce interest rates and other benefits of the program before contacting the consumer. The script provided sample language to be used upon contact. It read as follows:

"Hi, Sir? Hey it's _____ over at ORG. I received your paperwork back and I would like to go over the benefits with you, if this a convenient time? Great. Before we CO-16t were there any questions you had with the paperwork we had sent you, not about the payments or reduction of interest but just about the paperwork in general. (Give them a chance to respond and answer any questions they have so far.) Let's look over your accounts together and I will let you know exactly what you can expect. It will be helpful if you have your paperwork handy so you can take notes if you like. (If the paperwork is not available continue anyway.) According to my calculations your new monthly payment is going to be _____. Is that in your budget? With that payment your creditors should also reduce the rates down to _____. Isn't that a lot better than your rates now? With that payment and lower interest rates we hope to have these bills paid back much faster.

The employee would then proceed to obtain information on the client's pay date to determine the earliest possible date that the consumer could begin to make the monthly payments. Employees were instructed to stress the urgency of them getting CO-16. An offer is then made for the payment to be drafted from the individual's account by providing the necessary financial institution information over the phone. Consumers were also told that they could use Quick Collect offered by Western Union and that ORG do accept any type of certified funds such as money orders or certified checks from banks. This script also provided information on matters relative to creditors contact with the consumer even after ORG has contacted the creditors. Consumers were told not to panic but to refer such calls to ORG.

Consumers were told that if they could make a payment to their creditors and one to ORG then that would be great but if they could only make one payment then they should send it to ORG as soon as possible so they could begin speaking to the consumer's creditors.

The final section of How to Solidify a Deal script instructs the employee to tell the consumer about a package that would be sent to them. According to the script the package would include a

confirmation letter highlighting the payment dates, pre-addressed envelopes, and payment coupons to be used when making the monthly payments.

The next important step for the employee was to get the consumer to send in the payment. The instruction in the script titled "Getting an account to pay" was used for this step. Employees were instructed in this script "It is very important to keep in touch with your clients so they can keep you informed as to how things are going for them. You should call your client once a week until payment comes in."

Once the payment was received, the employee prepared the file which was sent to Client Services (CO-2)

The training package provided information to the employees on how to handle calls from clients that were already on the program. Noted in the opening paragraph is the following "Every counselor that has enrolled a client onto the program knows how frustrating it is to get a call from a client that is already making payments and should be working with Client Services. In a refund survey the #1 reason for clients dropping the program was that they claimed their counselor never called back when they had a question or problem. I realize that you didn't apply for a customer service position and I don't want you doing back end customer service work". Based on this paragraph it appears that employees no longer wanted to communicate with clients once they were enrolled in the program.

The budget worksheet faxed or mail with the agreement to the consumer asked for categories of monthly net income and list of monthly expenses. The form was not beneficial to the consumer with regards to budgeting or other aspect relative to control of spending since the employee did not use it has a tool to educate the customer on their personal spending habits or to assist the consumer to develop an effective budget. Per EMP-13, Sales Manager in response to questions 10, 11 & 12 (see Exhibit 41), ORG did request a budget worksheet because some credit card company required that they have the consumer fill it out. He further stated that they never used the budget worksheet information because they were never told that they had to use it. Per EMP-14 questionnaire response (see Exhibit 42), he indicated the following "In the beginning we did not ask for the budget worksheet, but later on yes we did. We asked for the work sheet to see what expenses the customer had and what income to help us have a better idea of how much they could send on a monthly basis." Per EMP-6 questionnaire response, the budget worksheet was used to qualify the consumer for the program (see Exhibit 31). Thus, based on the responses, the budget worksheet was not used in an evaluative manner or any other manner relative to credit counseling. Based on the manager's response, ORG did not deem this information necessary for the "consultation" process and neither did ORG utilized this information to determine eligibility for the DMP or to determine whether or not the consumer could afford the payment to the creditor, or the one-time "contribution" or monthly payment to ORG. The completion of the form was to comply with the requirement of some credit card companies that the form be completed. It appears that some employees did review the form but primarily to determine how much monthly payment the consumer could send in as opposed to using the information to educate on how to develop good spending habits or to assist the consumer to devise a budget which would assist them to control their spending.

During all contacts with the consumers, the employees were given various scripts to address questions or resistance that they may encounter. Such include the following:

A) If a consumer asked "What is my contribution used for?" Response: "The contribution is used to cover the cost of setting you up on the program and anything left over is put back into the company to provide clients with the best service possible."

B) If a consumer stated "How do I know that your company is legitimate?" Response: "We are a Federally approved not for profit organization and are under strict guidelines. We have a great relationship with many creditors who will verify our company. Once you complete the paperwork and before you send money, I will ask you to refer any creditor calls to me."

C) If asked "If you are not for profit why do you ask for contributions?" Response: "Please understand that we are a federally approved but not federally funded. A not for profit organization means that we cannot take in funds above and beyond what it cost to operate our business and we do rely on contributions from the consumer to cover our daily needs. We get audited by the federal government to make sure we were not stock piling money or operating lavishly. If the government thought that we were not following the 501(c)(3) guidelines they would revoke our not for profit status and we would be out of business. Even a not for profit organization will incur cost while establishing an account, in the first month there are administrative cost, data entry and a lot of creditor service that must be done properly or you will not receive the true benefit of the counseling program, our utility bills and this phone call have to be paid for. Some of the lenders we work with may have some processing cost that have to be covered when applying you for financing. ORG simply asks each consumer to donate the funds that are necessary to cover the cost incurred establishing your account, which usually equals one payment on the program."

Employees were asked in the questionnaire (question 7) to state the primary purpose of their contact with a consumer. EMP-14 response was as follows (see Exhibit 42) "For the customer to make a voluntary contribution to DCC and make regular monthly payment to pay off their debt." Per EMP-13 response (see Exhibit 41) "To get them to join the program". Per EMP-8 response (see Exhibit 33) - "To introduce program available to them to get out of debt." Per EMP-15 response (see Exhibit 43), "To see if they qualified for debt consolidation."

Referrals of Customers by ORG Employees. In response to the questionnaire item 27, EMP-15 (see Exhibit 43) indicated that ORG did make referrals to CO-24 (CO-24) for those customers who made at least 7 months on time payment. His statement is consistent with the script in which ORG stated that individuals may be able to get a loan if they made 7 consecutive on time payments.

A review of ORG's website showed a link that said "homeowners click here". The link takes the consumer to a website which shows the name of CO-25 Consumers were provided an opportunity to apply online or to call a phone number to get pre-approved in minutes. The copyright notes on site

stated the following "NoEquityNeeded.com a marketing agent of CO-25". See Exhibit 44 for copies of website information.

Documents Provided by ORG's Employees to the Consumer for Enrollment. To enroll in ORG's debt management program, consumers were provided the following forms and information via facsimile to be completed and returned to ORG:

- a) A thank you letter to the consumer for applying to ORG. The letter also instructs the consumer to complete the forms and send them back because by doing that they are allowing ORG to provide a free evaluation of their financial situation and to determine their monthly payment and interest reduction.
- b) A one-page document which touted all the "benefits" of ORG's debt management program. Such listed "benefits" included one lower monthly payment, reduction in interest, improved credit, late and over the limit fees stopped, and end of creditor harassment.
- c) The "Agreement" provided the terms of the DMP.
- d) An "AUTHORIZATION TO RELEASE INFORMATION" form – allowed ORG to negotiate with the consumer's creditors.
- e) Creditor Information Sheet – requested a list of all unsecured creditors including amount owed.
- f) A Budget Worksheet

(See attached Exhibit 45 for copies of documents sent to consumers for enrollment purposes).

Once the consumer was enrolled in the program and the initial payment was received a **Welcome Package** (see Exhibit 46) was sent to the new enrollee. The package contained all or some of the following information.

- a) Letter of Congratulations to the consumer for making the decision to work with ORG. The letter also informed the consumer that their files have been forwarded to ORG Client Processing Center. Consumers were instructed to direct all future questions or concerns to Client Processing Center (CO-2). Also included in the letter was a reminder to the consumer to make timely payments and to monitor their statements.
- b) One page instructions – telephone number of client services provided and instructions to call client services with future questions; the address to which all future payments should be made and payment form (cashier's check, money order, etc.).
- c) A one page list of Do's and Don'ts and What Ifs which include information such as –
 - a) do mail your payment promptly, b) do not miss payments c) Do apply for additional credits d) what if my payment is late e) what if I withdraw from the program f) what if I lose my job
- d) The Welcome Package also included a Two-page handout titled "IMPORTANT!" which consisted of things the consumer needed to remember. The reminder items were as follows: a) If creditors called, ask them to call Client Services Center b) How to make monthly payments – cashier's check, certified bank check, money order or Western Union with name, social security number and address on the check. c) Call Client Services Center if full payment cannot be made d) information on the negotiation period

- e) possible slight increases might be proposed by creditors f) what do if client's financial situation changes
 - e) List of creditors that the enrollee must call to change their payment due date
 - f) A ½ page document dealing titled "Helpful Hints for handling Third-Party Bill Collectors"
 - g) A one page document providing information on guidelines relative to authorization of EFT payments
 - h) Authorization agreement to be completed by consumer if they choose to have their payments withdrawn directly from their checking accounts
- (See Exhibit 46 for contents of a sample Welcome Package).

Customer Service Operations as Provided by CO-2

In August 20XX, ORG contracted with a for-profit company, CO-2, to provide "customer service" to ORG's clients. Per the agreement, CO-2 was retained to perform fulfillment, back-office and customer relations services to ORG budget plan clients. Once the completed application and all related documents including the initial contribution had been secured from the consumer, a package was prepared and forwarded to CO-2. Basically, CO-2 was the processing center for ORG during the years under examination and provided services such as, submission of proposal to the creditors, payment processing, data entry, and customer service to the clients. CO-2 also handled the fair share payment received from the creditors for distribution to ORG. Page 3 of the agreement excludes intake and counseling services from CO-2 obligations (see the Fulfillment Agreements in Exhibit 11). The agreement also stated that ORG "will have no further direct contact with the client other than telephone or face-to-face contact initiated by the client for the purpose of receiving additional counseling."

In response to question 42 on the interview questionnaire, ORG employees, EMP-6, EMP-16, and EMP-13, all said they never called the consumer back to provide additional counseling. As noted earlier in how to handle clients that are already on the program, employees found it frustrating to have to deal with consumers who have already enrolled in the program. Thus, once an individual was enrolled in a DMP, ORG's employees preferred to have no further contact with the consumer and did not initiate any subsequent contact with the consumer to provide credit counseling.

According to Part II of Schedule A of Form 990 for the year 20XX, ORG indicated that it incurred total expenses of \$ relative to DMP services provided by CO-2 (see Exhibit 47 for Form 990 disclosure and general ledger information).

Website Operations

Using the internet site for "Internet Archive" website copies of ORG website were retrieved from archive for several dates for 20XX and 20XX (see Exhibit 44 for copies of websites). An overview of the information on the website is discussed below. The following categories of information as listed in ORG sitemap is as follows:

The beginning of each site shows the following statements: "ORG a non-profit organization Counselors are standing by to help you erase your debt! M-F 10:a.m. to 10 p.m. Est Call us at

➤ Debt Load test - This portion of the website listed 7 seven questions for consumers to respond to. It includes the following questions.

"Do you..."

Pay only monthly minimums or miss payments on charge accounts?

Combine debts by borrowing from a high-interest lender?

Rely on overtime or a second job to cover monthly bills?

Panic when faced with an unexpected expense, such as car repairs?

Hope that checks you've written don't clear the bank before payday?

Borrow from friends and relatives to cover basic expenses?

If you've answered "yes" to any of these questions, you may be heading for financial trouble. WE CAN HELP!"

➤ About ORG - This section focus on the question "What Can ORG Do For You?" In response the following are listed; a) Reduce your minimum payments—as much as 50% b) Consolidate your multiple payments into one simple monthly payment! c) Eliminate or reduce interest rates! d) Eliminate late charges and over the limit fees! e) Re-age past due accounts to improve credit rating f) Provide Free Consultation f) Home Ownership Not Required". Also included in the section was the question "Who is ORG?" In response the following was indicated as a part of their response "ORG offers the most beneficial programs in the industry! We offer many unique solutions, which include: debt consolidation loan programs and/or debt management programs."

➤ Steps /Results: - Provides steps associated with the debt management program which includes a) review of credit and budget information to determine eligibility for loan program or DMP b) Decision on date of first payment to ORG c) negotiations with creditors d) clients to make monthly payments on time

➤ Frequently Asked Questions - includes questions such as "why can't I just negotiate with creditors on my own?"; "why can't I just keep paying off my creditors on my own?"; "how much will it cost me to be on the debt management program?"; "how will joining ORG's program affect my credit rating?"; "Can I send in more money once I have better cash flow?"; "Will I still receive harassing phone calls?" The site provides a response for each question.

➤ Interest Calculator: Feature to allow consumers to determine how long it will take them to pay off their bills once the monthly payment, interest rate and principle balance is entered.

➤ Documents - permits only individuals who have already been contacted by ORG to enter a password given to them to obtain necessary documentation and applications.

➤ Existing Clients - Section is for clients who have already enrolled by making their first payment.

➤ The site also has a link to the application which asked for name, phone number, address, email address, amount of unsecured debt (must be at least \$), best time to reach consumer, whether or not the person rent or own their home, if their mortgage was past due or current and if past due how long; and a section to check the types of debt i.e. credit cards, personal loans, medical bills, etc.

- On each page was a link which states "Homeowners with GOOD CREDIT click here". Clicking on this link takes the consumer to a website which shows the name CO-30. Consumers were provided an opportunity to apply online or to call a number to get pre-approved in minutes. Noted at the bottom of the page is the following statement "website a marketing agent of CO-30"

In questions 14 and 15 of the questionnaire the employees were asked if ORG had educational materials posted on its website and was it a requirement for employees to direct callers to the website to review educational materials. Per EMP-13, Sales Manager, (Exhibit 41) ORG did not have educational materials posted on their website and it was not a requirement to direct callers to the website to view educational materials. Callers were directed to the website but only to get the forms needed to list the debts.

(see Exhibit 44 for a copy of the website).

Fees

In response to IDR #1, questions 23, 24, and 25 (see attached Exhibit 48), the organization provided the following response in describing its fee structure. "ORG does not charge any fees for their services. They instead request voluntary contributions from their clients and three creditors. Clients contributions are based on the clients total debt load and number of creditor accounts. The client was asked to contribute their first program payment and an amount of six dollars per creditor we handled on monthly bases. All creditors were asked to make a fairshare contribution based on consumer payments sent by ORG. The fairshare amount asked was 15%, however many creditors paid less will other made no contribution at all."

Included in the agreement in which the client was asked to sign was the following statement. "I understand that ORG does not charge any required "advance fees" for any of their programs, but I understand that I have been requested and voluntarily agree to make a one time non-refundable "counseling" contribution to ORG equivalent to one payment on the debt management program that will be procured from my first payment. I understand that the "counseling" contribution will be used to cover the operational costs involved in setting up my account and negotiating with my creditors. I further understand that in addition to the one time "counseling" contribution, I have also been requested and agree to make a voluntary "monthly" contribution of \$ per account that ORG is handling for me." See Exhibit 49 for copy of agreement.

Revenue Sources

According to its Form 990 return (see attached Exhibit 1), ORG generated total revenue of \$ for the year, 20XX. Revenue was generated from three main sources: A review of the adjusted trial balance for period ended December 31, 20XX showed a breakdown of all revenue sources as listed in

account numbers 40200 (New Client Payments), 4100 (Contribution Revenue), and 41400 (Fair Share Revenue). See Exhibit 27 for copy of adjusted trial balance

1. The initial enrollment fee or "first pay" requested from each individual who enrolled in the debt management plan. Consumers were asked to give 3% of their debt load as an initial "contribution" which was approximately equal to one monthly payment.
2. The monthly fee of \$ per account requested from each participant who enrolled in a debt management plan.
3. Amounts received from creditors which were classified as fairshare revenue.

From August 1, 20XX to December 31, 20XX, a total of 181,899 clients were contacted by the organization. Of this total, 17,861 clients used the services of ORG. ORG collected \$ in enrollment contributions from the 17,861 clients (see Exhibit 65 for response to IDR 001, question 7)

Revenue Type	Amount (TY 20XX)	% of total Revenue (TY 20XX)
First Payment		
Monthly Fee		
Fair Share		
Overall		

For 20XX overall amounts paid by consumers to ORG for services constitute approximately 98%, of total revenue.

President, CO-2, CO-1 and EMP-1

As stated previously, President founded CO-1, and eventually spun-off the customer service department (also referred to as back office services) to his for-profit company, CO-2, on 9/1/19XX. As of 9/1/19XX, CO-2 serviced all of CO-1's back office functions as well as all of the CO-1 spin-off CO-26 including ORG. Upon formulation of a spin-off CCA, a Fulfillment Agreement is executed by CO-3 and the CCA (see ORG Agreement in Exhibit 11). Substantial fees are then remunerated to CO-3 by the CCA for customer service.

EMP-1 (brother of President) was a former employee of CO-1 (see EMP-1 interview, in Exhibit 18). ORG was one of 11 spin-offs that utilized former employees of CO-1 or close friends or family of President (see the CO-1 Bankruptcy examiner's report detailing the CO-16t-up individuals of CO-1 spin-offs and their relationships to CO-1 and President in Exhibit 7). EMP-1 was able to CO-16 ORG with co-opted elements from CO-1 and assistance, financial and marketing, from President. President gave EMP-1 a \$ loan to assist in the initial phase of the operation (see Exhibit 18 for EMP-1 interview and Exhibit 19 for copy of note). EMP-1 also received leads from CO-1 as its primary marketing source to find potential DMP clients (again, see EMP-4 Deposition, 1/14/20XX, page 139 (see Exhibit 58). The CO-16t up funds and leads were critical to the formation and going concern of ORG. The formation of ORG allowed excess CO-1 leads to be timely

serviced by ORG and CO-3 would be able to receive exorbitant fees for servicing of these DMPs clients.

As stated, CO-1 advertised heavily and received many leads for potential DMP clients. CO-1 would utilize CO-7 and EMP-4 to reconcile the distribution of these leads to various CO-26, including ORG (see EMP-4 deposition, 1/14/20XX, page 139, 142 of Exhibit 58. ORG was CO-16 as a vehicle to service the excess leads that CO-1 could not service and solicit for DMPs.

ORG also utilized a former CO-1 Director and CO-2 COO, EMP-17, and his company, CO-27, for purchases of leads (see Exhibit 50 for copy of lead invoice from EMP-17)

ORG has paid numerous amounts to CO-3 for back office processing. An amount of \$ was paid to CO-3 for calendar year 20XX (see Exhibit 47)

In addition to the back office processing fees, CO-2 provided advertising and leads to ORG. CO-2, in its January 10, 20XX invoice to ORG, included advertising costs for December 20XX in the amount of \$ (see Exhibit 51 for copy of invoice. Leads provided by CO-7 are seen in CO-3's monthly invoices.

The Fulfillment Agreements with CO-2 and Due Diligence by ORG

ORG provided the Service with copies of its fulfillment agreements (See Exhibit 11) for copies of agreement. A summary of the provisions in the agreement is as follows:

- ORG retained CO-2 to provide fulfillment, back-office, and customer relations services for ORG budget plan clients.
- Once CO-2 has received documentation for a client from ORG, ORG agreed that it would have no further direct contact with the client other than telephone or face-to-face contact initiated by the client for the purpose of receiving additional counseling.
- ORG must submit to CO-3 all the documentation for each new budget plan client within 5 business days following the first remittance
- ORG must maintain and give CO-2 full access to such bank accounts to allow for the deposits of money, payment of refunds, and the payment of funds on behalf of the CO-26 budget plan clients. ORG can remove monies from the accounts; the balances can not fall below the amounts necessary to operate the client's budget plans
- CO-3 shall deposit client budget payments into the creditor accounts no later than the fifth day of receipt. CO-3 shall deposit fairshare monies solicited from creditors no later than the next business day of receipt
- Compensation for the services provided is \$ as a one time fee for the initial set up of a new client payment plan. A fee of \$ per client plan per month for each client on which CO-3 received payments on behalf of during that month is imposed. The invoicing should include total receipts from the clients, a listing of the portion of the client receipts that represent client contributions, a listing of the fair share portion of the payment received from creditors, and total distribution to creditors.
- The term of the agreement is 5 years, which automatically renews for an additional period of 5 year unless one of the parties has given notice to the other no less than one year prior to the end of the lease agreement.

The agreement was signed by EMP-1 for ORG and President for CO-2.

ORG and CO-3 signed a new fulfillment agreement effective September 1, 20XX (see Exhibit 11 for copy of agreement) through the signature of EMP-1 and President. The major changes were as follows:

- Paragraph 2C was revised to include the following statement "Any interference with CO-2's exclusive access to such account(s), as by writing any check or withdrawing any funds from such account(s), shall represent a substantial breach of this agreement entitling CO-2 to terminate this agreement and/or recover (100%) of the amount of the check or withdrawal."
- Item B was added to section 4 which stated that in the event fees payable to CO-2 are past due, CO-2 would have the option to apply towards the past due amount funds that are required to be paid to ORG. It also included item C which stated that all fees payable under section A would increase by 3% over the fees in effect. In addition, CO-2 may at any time during the term of the agreement give notice to ORG of a proposed fee increase.
- Item 6C was revised to include information relative to ORG being in default of its obligation at time of termination. It included the following statement "In the event that, at the time of termination, Agency is in default of any of its obligations under this Agreement, CO-2 may, at its sole option and without limiting any other remedy that might be available to it, assign Agency's clients to one or more other credit counseling agencies, exempt from federal tax under section 501(c)(3) of the Internal Revenue Code."

Lack of Meaningful Due Diligence

EMP-1 indicated that no bidding process was used and neither was any financial analysis completed prior to the selection of CO-2 as the company's back office service provider. EMP-1 in his interview stated that he spoke with CO-28 a back office company whose fees were a little greater than CO-2. He indicated that CO-2 was selected because his brother was involved with CO-2 as its owner and CO-2 had the experience. In addition, he stated that CO-2 also allowed ORG to operate a few months, approximately 90 days) before it CO-16 billing for its services. EMP-1 stated that it was a business decision that he made to contract with CO-2 since he did not know how to do the back office work. He stated that no due diligence was done before signing the contract but that the matter was discussed with the board. ORG did not provide any documentation to show that it performed any due diligence in selecting, determining, pricing, and vetting CO-2 as a vendor. (see EMP-1 President interview Exhibit 18)

Payments to CO-2 under the Fulfillment Agreements and Fair Market Value

Under the Fulfillment Agreements, the following expense amounts were paid by ORG for back office services only:

	20XX Expenses	% of Total Expenses
CO-2-Back office		
Form 990 - Total Expenses		

According to the Form 990, ORG's total expenditures for 20XX were \$.

The IRS Engineering Report and overpayments to CO-2

The IRS valued the Fulfillment Agreements and fair market value of the customer service functions performed by CO-2..

The IRS Engineering Report concludes that for 20XX the reasonable fulfillment fees to be paid by ORG should be \$. The amount paid by ORG was \$ which resulted in an over charge of \$ (see IRS Engineer's report in Exhibit 52).

EMP-1 has indicated that ORG has closed all of its offices and has not been conducting business. (See Exhibit 66 for copy of E-mail dated 2/24/20XX)

LAW

Section 501(a) of the Internal Revenue Code provides that an organization described in section 501(c) (3) is exempt from income tax. Section 501(c)(3) of the Code exempts from federal income tax corporations organized and operated exclusively for charitable, educational, and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual. The term charitable includes relief of the poor and distressed. Section 1.501(c) (3)-1(d) (2), Income Tax Regulations.

The term educational includes (a) instruction or training of the individual for the purpose of improving or developing his capabilities and (b) instruction of the public on subjects useful to the individual and beneficial to the community. Treas. Reg. § 1.501(c)(3)-1(d)(3). In other words, the two components of education are public education and individual training.

Section 1.501(c)(3)-1(a)(1) of the regulations provides that, in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. The existence of a substantial nonexempt purpose, regardless of the number or importance of exempt purposes, will cause failure of the operational test. Better Business Bureau of Washington, D.C. v. U.S., 326 U.S. 279 (1945).

Educational purposes include instruction or training of the individual for the purpose of improving or developing his capabilities and instruction of the public on useful and beneficial subjects. Treas. Reg. § 1.501(c)(3)-1(d)(3). In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purposes, if substantial in nature, will destroy the exemption regardless of the number or importance

of truly exempt purposes. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

Similarly, in American Institute for Economic Research v. United States, 302 F.2d 934 (Ct. Cl. 1962), the Court considered the status of an organization that provided analyses of securities and industries and of the economic climate in general. The organization sold subscriptions to various periodicals and services providing advice for purchases of individual securities. Although the court noted that education is a broad concept, and assumed for the sake of argument that the organization had an educational purpose, it held that the organization had a significant non-exempt commercial purposes that was not incidental to the educational purpose and was not entitled to be regarded as exempt.

Rev. Rul. 69-441, 1969-2 C.B. 115, granted exempt status under section 501(c)(3) to an organization with two functions: it educated the public on personal money management, using films, speakers, and publications, and provided individual counseling to "low-income individuals and families." As part of its counseling, it established budget plans, i.e., debt management plans, for some of its clients. The debt management services were provided without charge. The organization was supported by contributions primarily from creditors. By virtue of aiding low income people, without charge, as well as providing education to the public, the organization qualified for section 501(c)(3) status.

In the case of Consumer Credit Counseling Service of Alabama, Inc. v. U.S., 44 A.F.T.R.2d 78-5052 (D.D.C. 1978), the District Court for the District of Columbia held that a credit counseling organization qualified as charitable and educational under section 501(c)(3). It fulfilled charitable purposes by educating the public on subjects useful to the individual and beneficial to the community. Treas. Reg. § 1.501(c)(3)-1(d)(3)(i)(b). For this, it charged no fee. The court found that the counseling programs were also educational and charitable; the debt management and creditor intercession activities were "an integral part" of the agencies' counseling function and thus were charitable and educational. Even if this were not the case, the court viewed the debt management and creditor intercession activities as incidental to the agencies' principal functions, as only approximately 12 percent of the counselors' time was applied to debt management programs and the charge for the service was "nominal." The court also considered the facts that the agency was publicly supported and that it had a board dominated by members of the general public as factors indicating a charitable operation. See also, Credit Counseling Centers of Oklahoma, Inc. v. United States, 79-2 U.S.T.C. 9468 (D.D.C. 1979), in which the facts and legal analysis were virtually identical to those in Consumer Credit Counseling Centers of Alabama, Inc. v. United States, discussed immediately above.

The organizations included in the above decision waived the monthly fees when the payments would work a financial hardship. The professional counselors employed by the organizations spent about 88 percent of their time in activities such as information dissemination and counseling assistance rather than those connected with the debt management programs. The primary sources of revenue for these organizations were provided by government and private foundation grants, contributions, and assistance from labor agencies and United Way.

Outside the context of credit counseling, individual counseling has, in a number of instances, been held to be a tax-exempt charitable activity. Rev. Rul. 78-99, 1978-1 C.B. 152 (free individual and group counseling of widows); Rev. Rul. 76-205, 1976-1 C.B. 154 (free counseling and English instruction for immigrants); Rev. Rul. 73-569, 1973-2 C.B. 179 (free counseling to pregnant women); Rev. Rul. 70-590, 1970-2 C.B. 116 (clinic to help users of mind-altering drugs); Rev. Rul. 70-640, 1970-2 C.B. 117 (free marriage counseling); Rev. Rul. 68-71, 1968-1 C.B. 249 (career planning education through free vocational counseling and publications sold at a nominal charge). Overwhelmingly, the counseling activities described in these rulings were provided free, and the organizations were supported by contributions from the public.

Internal Revenue Code section 501(c)(3) specifies that an exempt organization described therein is one in which "no part of the net of earnings inures to the benefit of any private shareholder or individual." The words "private shareholder or individual" in section 501 refer to persons having a personal and private interest in the activities of the organization. Treas. Reg. § 1.501(a)-1(c). The inurement prohibition provision "is designed to prevent the siphoning of charitable receipts to insiders of the charity" United Cancer Council v. Commissioner, 165 F.3d 1173 (7th Cir. 1999). Reasonable compensation does not constitute inurement. Birmingham Business College v. Commissioner, 276 F.2d 476, 480 (5th Cir. 1960).

An organization must establish that it serves a public rather than a private interest and "that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests." Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii). Prohibited private interests include those of unrelated third parties as well as insiders. Christian Stewardship Assistance, Inc. v. Commissioner, 70 T.C. 1037 (1978); American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989). Private benefits include an "advantage; profit; fruit; privilege; gain; [or] interest." Retired Teachers Legal Fund v. Commissioner, 78 T.C. 280, 286 (1982).

An organization formed to educate people in Hawaii in the theory and practice of "est" was determined by the Tax Court to a part of a "franchise system which is operated for private benefit," and, therefore, should not be recognized as exempt under section 501(c)(3) of the Code. est of Hawaii v. Commissioner, 71 T.C. 1067, 1080 (1979). Although the organization was not formally controlled by the same individuals who controlled the for-profit entity that owned the license to the "est" body of knowledge, publications, and methods, the for-profit entity exerted considerable control over the applicant's activities by setting pricing, the number and frequency of different kinds of seminars and training, and providing the trainers and management personnel who are responsible to it in addition to setting price for the training. The court stated that the fact that the organization's rights were dependent upon its tax-exempt status showed the likelihood that the for-profit entities were trading on that status. The question for the court was not whether the payments made to the for-profit were excessive, but whether the for-profit entity benefited substantially from the operation of the organization. The court determined that there was a substantial private benefit because the organization "was simply the instrument to subsidize the for-profit corporations and not vice versa and had no life independent of those corporations."

In International Postgraduate Medical Foundation, T.C. Memo. 1989-36, one individual controlled both a nonprofit that ran tours aimed at doctors and their families and a for-profit travel

agency that handled all the nonprofit's tour arrangements. The non-profit spent 90 percent of its revenue on travel brochures prepared to solicit customers for tours arranged by the travel agency. The tours were standard sightseeing trips, with little of the alleged medical education that was the basis for exemption. The Tax Court held the petitioner was not tax exempt, finding that it was operated for the benefit of private interests, namely the founder's travel agency. The court found that a substantial purpose of the nonprofit was to increase the income of the travel agency. (In this case there was both inurement and private benefit.) Also, its activities were directed at providing opportunities for recreation, not education.

The Credit Repair Organizations Act (CROA), Pub. L. No. 104-208, § 2451, 110 Stat. 3009-455 (Sept. 30, 1996), 15 U.S.C. § 1679 *et seq.*, effective April 1, 1997 imposes restrictions on credit repair organizations, including forbidding the making of untrue or misleading statements and forbidding advance payment, before services are fully performed. 15 U.S.C. § 1679b. Significantly, section 501(c)(3) organizations are excluded from regulation under the CROA.

The CROA defines a credit repair organization as:

(A) any person who uses any instrumentality of interstate commerce or the mails to sell, provide, or perform (or represent that such person can or will sell, provide, or perform) any service, in return for the payment of money or other valuable consideration, for the express or implied purpose of—

(i) improving any consumer's credit record, credit history, or credit rating, or

(ii) providing advice or assistance to any consumer with regard to any activity or service described in clause (i).

15 U.S.C. § 1679a(3). The courts have interpreted this definition broadly to apply to credit counseling agencies. The Federal Trade Commission's policy is that if an entity communicates with consumers in any way about the consumers' credit situation, it is providing a service covered by the CROA. In Re National Credit Management Group, LLC, 21 F. Supp. 2d 424, 458 (N.D.N.J. 1998).

Businesses are prohibited from cold-calling consumers who have put their phone numbers on the National Do-Not-Call Registry, which is maintained by the Federal Trade Commission. 16 C.F.R. § 310.4(b)(1)(iii)(B); 47 C.F.R. § 64.1200(c)(2). Section 501(c)(3) organizations are not subject to this rule against cold-calling. Because 501(c)(3) organizations are exempt from regulation under the CROA and the cold-calling restrictions, organizations that are involved in credit repair have added incentives to be recognized as section 501(c)(3) organizations even if they do not intend to operate primarily for exempt purposes.

ORG'S POSITION

Unknown.

GOVERNMENT'S POSITION

Discussion – 1023 Application

In June 20XX, ORG presented a Form 1023 Application outlining several proposed educational activities which purportedly would constitute approximately 80% of its operations. Based on representations made in ORG's Application, the IRS granted exemption under section 501(c) (3) of the Code. However, based on the Service's review of the evidence gathered through its examination, it has been determined that a significant portion of the activities outlined in the application did not correctly represent how the organization did, in fact, actually operate. Moreover, ORG did not conduct about 80% of the activities it proposed in its application.

Specifically, in the Form 1023 Application, ORG indicated that it would conduct financial and budgeting workshops offered free of charge to religious organizations civic groups, businesses, labor unions, businesses, and educational organizations. ORG's Application also discussed the use of videos, pamphlets and other education materials on budgeting and buying practice, and sound use of consumer credit to be provided free of charge to the groups listed above. ORG did not conduct financial and budgeting workshops. ORG did not distribute materials or make available materials discussed in its Application to the local groups. There were no indications that it ever attempted to include any of the local groups in any aspect of its operations

Discussion – Actual Activities

Based on information obtained during the examination, it was determined that the primary activity of ORG was not educational in the manner described in the Form 1023 Application and was not "educational" or "charitable" as defined under the Internal Revenue Code, its Regulations, or legal precedence. The primary activity was the sale of debt management plans. This determination was made based on the types of activities that ORG conducted and the manner in which they were conducted. These factors together demonstrate that ORG's operations were not consistent with section 501(c) (3) of the Code.

Advertising: ORG engaged in extensive advertising activities in order to generate leads and made significant expenditures to purchase leads from lead generation companies. The procurement of leads was essential to ORG's objective to market its debt management plan (DMP). The magnitude of its advertising and lead generation activity is reflected in the percent that advertising/lead expenses represent to the overall expenditures of the organization. ORG's overall expenditures of \$ include an amount of \$ for leads/advertising. (See exhibit 27 for lead/adv costs). Thus, 20XX, 28% of ORG's overall expenditures were spent on advertising and lead generation.

Based on the review of ORG's advertisement on its website and its advertisement materials, ORG had several general points that it wanted to communicate to consumers in its advertisements.

- 1) Reduce minimum payments, as much as 50%;
- 2) Consolidate multiple payments into one;
- 3) simple monthly payment;
- 4) Eliminate or reduce interest rates;
- 5) Eliminate late charges and over the limit fees; and
- 6) Re-age past due accounts to improve credit rating.

The duration of the commercials was 60 seconds in length. The presentation and content of ORG's commercials were substantially similar to those used by commercial enterprises to market their products.

Leads generated by lead companies were procured mainly through banners strategically placed on various websites to advertise debt consolidation services. Although ORG's name may or may not have been associated with advertisements on the banners, such vendors were commercial companies whose sole purpose was to generate leads for sale, not to educate consumers.

In addition to its radio commercials, and purchasing leads from vendors, ORG also extended its advertising efforts through the use of internet campaign. The formats of the internet campaigns banners were
ORG also used print media in the form of publications to advertise its services.

The time frames for radio commercials and the line spacing used in the publications and in the internet campaigns did not allow ORG to present extensive amount of information to the general public. However, within the constraints of time or space, ORG consistently informed consumers of the availability of its debt management plan, giving quick highlights of the alleged benefits of the program. Thus, the advertising language used within the time frame served to market the debt management plan.

Every form of advertising or marketing technique used by ORG exclusively promoted the availability of its DMP product and the alleged benefits of the program. ORG advertisements advocated the sale or availability of the DMP product and did not provide "education" or any "charity" within the meaning of section 501(c) (3) of the Code. The term "educational" includes "The instruction of the public on subjects useful to the individual and beneficial to the community." In ORG's case, however, its advertisements lack instructional information the nature of which could assist a financially distressed individual to cultivate credit practices that would eliminate or minimize future financial disasters. The advertisements did not provide information such as budgeting techniques, buying practices, or sound use of consumer credit which is generally a part of the provision of credit counseling and which ORG presented as a part of its proposed activities in the Form 1023 Application. The advertisements did not fall within the parameters of individual counseling. Rather the advertisements served a commercial purpose and were being used as a marketing tool to sell debt management plans.

The advertising and marketing campaigns generated a significant amount of leads which were used by employees to market the debt management program. ORG's operations were statistically driven and were reflected in the manner in which employees were compensated.

Employee Qualification, Training and Compensation. To achieve its monthly goals, ORG designed a compensation package for its employees based on production. Employees were required to sign a performance agreement at the time they were employed to acknowledge that salary ranges are "commensurate with account achievements" (see Exhibit 53). Each employee's base salary and bonus/commission was based on the number of enrolled consumers and the amount of contribution that the employee acquired (see Exhibit 38). If the figures were in line with management's expectations, the form showed an increase in salary for that employee. Employee personnel files

also showed decreases in salaries when production was not in line with management's expectations (see Exhibits 38). Due to the personal financial gain, the incentive was present for employees to quickly push consumers into a DMP. There was no incentive for employees to provide meaningful education or counseling since consumer enrollment in the DMP was their top priority.

Failure to produce at minimum acceptable levels resulted in the employee being counseled and/or terminated. Review of various personnel file folders showed the upward or downward adjustment of the employees' base salary based on their production. Personnel folders reviewed also showed employees being terminated for inadequate production. In the personnel file for EMP-18 the termination form stated the reason for his termination as follows: "EMP-18 did not adapt well to commissioned sales environment." (See Exhibit 54 for EMP-18 personnel file). In personnel file for EMP-9 the reason for his termination was due to low sales volume over a 3 to 4 months period. (See Exhibit 55 for EMP-9 personnel file). EMP-19 termination form in the personnel file showed reason for termination as "Not meeting sales quota". (See Exhibit 56 for EMP-19 personnel file).

ORG created a "telemarketing" sales environment which resulted in consumers being pressured into enrolling in ORG's DMP. The environment was not conducive to provide meaningful education or counseling sessions.

Even though "Credit Counselors" formed the pool of employees responsible for the provision of "counseling" services to financially distressed individuals, ORG did not require applicants to have prior credit counseling experience or any counseling experience. It did not require candidates to have a certain level of education or knowledge in the field of credit counseling. Also, ORG did not require candidates to have any special license or certificates in the area of counseling. ORG's employment advertisements in the classified requested applicants with stock broker or collections experience. ORG's "Credit Counselor" position was similar to telemarketing positions and its advertisement in the local papers to fill such positions was similar to the classified ads used for sales/telemarketing positions (see Exhibit 28).

ORG provided 3 days of in-house classroom training and two days of observing and listening to senior employees selling the DMP to consumers. The training materials primarily focused on how to sell the debt management plan and aspects associated with the plan through the use of various scripts (see the Exhibit 30). According to EMP-14 (see Exhibit 42) in response to question 23 on the questionnaire "You were told to follow it [the script]... The script was proven so they said." According to the response to questions 23 and 24 from EMP-8 (see Exhibit 33) the consequences of not following the script resulted in employees being reprimanded or terminated. No significant training was provided on counseling methods, counseling techniques or on topics such as proper budgeting techniques, sound use of consumer credit, etc. The overall goal and purpose of the training was to assist employees to become excellent Telephone Sales Representative. How to sell the DMP was the primary purpose of the training. No training was provided to equip the employees with skills necessary to counsel in the areas of money management skills, or sound use of consumer credit.

As a result of ORG recruitment practices and the type of training that was provided, the employees neither had the experience, knowledge, or training, that would allow them to effectively counsel a financially distressed person. Neither did the employees' compensation package provide an

incentive for them to educate the consumers in the area of credit counseling. The scripts used had little or no educational content. Thus, substantially all of the training that was provided to the employees served to equip them to sell the debt management plans.

Scripted DMP Enrollment Sessions. To determine the type, level and quality of credit counseling that was allegedly provided to consumers, the examination team looked to the scripts since those were primarily the only tools that were used to impart information to the consumers. The training materials, including the scripts, also provide detailed information on the techniques that were used by the employees.

As stated previously, dialogue with consumers was controlled via the use of the script. Deviations from script lead to counseling or termination.

The overall basic purpose of the script was to determine if an individual meets the requirements for a debt management program and to convince consumers to enroll in the debt management program by outlining all the benefits associated with the program. Information provided to consumers to persuade them to enroll in the program included the following: a) detailed description of the benefits of a debt management program which includes low interest rates, reduce payments, one monthly payment, accounts are brought current, and balance are paid off faster, etc. Consumers were also told that ORG works with a network of lenders that may be willing to lend them money if they met certain criteria and make their payments on time each month 7 times in a row. Consumers were also told that if they were not approved for loan the lenders could negotiate a settlement with the creditors anywhere from 50 to 75 cents on the dollar, thus saving them even more money. The script repeatedly emphasized that employees should continue to "hit the hot buttons" which were basically the consumers response to question of what were their goals for applying for consolidation.

In the training materials (see Exhibit 30), the opening paragraph of the Initial Sales Presentation, trained employees to find out what the client wanted to do before they try to sell the program. The primary reason for obtaining this information was to provide the employee with the "hot button" used as a tool to manipulate the consumer needs in order to sell the program. Thus, determining the customer needs was not geared towards soliciting information that would allow the employee to understand the consumer's background or habits that are behind the problem of their indebtedness in order to provide meaningful counseling to address the problem. Instead, the employee focus was to find out the consumer main point of disappointment or motivation that led them to contact ORG and to use that information to pressure the consumer into thinking that a DMP is the solution for their crises and to ultimately enroll them in the program. See Exhibit 30 for copies of training materials.

The ultimate goal of each phone call is the enrollment of the consumer in the DMP. ORG did not provide consumer education or counseling to its callers outside the commercial realm of the debt management program. Per supervisor EMP-13 (see Exhibit 41) in response to questions 17 to 19 of the interview questionnaire, the average length of time for his initial phone call with a consumer is 10 minutes. He also stated that management's expectation in terms of length of time was 10 to 20 minutes. He further stated that if phone calls were very long employees would receive a verbal warning. Any limitation on talk time served to keep the entire focus of the conversation on the sale of the DMP product since it was not feasible for employees to sell the DMP product and educate consumers on personal money management during the amount of time allotted.

Employees were given a handout with a series of questions and answers to use to overcome objections that the consumer may have (see Exhibit 30). Most if not all of the answers to the questions used strategic sales language which served to push the consumer into the debt management program. None of these materials or strategies was geared towards educating consumers about how to exercise good judgment in the use of credit, or how to develop practices that could prevent future occurrence of financial crisis.

During the years under examination, the ORG scripts did not contain a section that allowed employees to discuss options with the consumer. On the script with the rebuttals one of the questions was as follows "Is bankruptcy an option for me?" In response the employee would read the following from the script "Bankruptcy is your last resort if we cannot work out an agreeable repayment plan based on the bills that you owe. We do not advise people to go bankrupt because this ruins their credit for at least 7-10 years." The mere fact that the discussion of bankruptcy only appears on the rebuttal script indicates that bankruptcy as an option is mentioned only if the consumer questioned to employee about that option. It also indicates that information on bankruptcy was not included in the initial presentation script and that management does not encourage any meaningful discussion on bankruptcy. The response to the bankruptcy is geared towards steering away consumers from that option and into the DMP ORG did not consider it a priority or necessity to educate the consumer about the various options via the script or during the telephone session.

Overall the script was a tool to effectively and efficiently sell debt management plans. The information that was provided relates to how the DMP program operated and the benefits of the programs. It provided no information that would assist the financially distressed to see why and how they came to be in a financial crisis. ORG, as a consistent part of its telephone session, did not address the consumer spending habits or budgetary matters in a personalized manner that would assist the consumer to prevent or minimize similar financial crisis. It provided no educational information or counseling in areas similar to those represented in its Form 1023 Application such as counseling on matters such as proper budgeting, buying practices and the sound use of consumer credit. It provided no information that was of an educational nature that would assist a financially distressed person to ultimately exercise sound judgment in the use of consumer credit or address the factors that originally created the financial distress.

After consumers were enrolled in the program, ORG had no further contact with the consumer unless the consumer initiated a call for "additional counseling." As a practical matter, consumers were given the telephone number for CO-2 for all future contact. Consumers were not told in the package that they could or should contact ORG for "counseling." Based on the information in the training materials titled "HOW TO HANDLE CLIENTS THAT ARE ALREADY ON THE PROGRAM", it is evident that both management and counselors considers calls from individuals who are already on the program as a nuisance. The opening paragraph states "Every counselor that has enrolled a client onto the program knows how frustrating it is to get a call from a client that is already making payments and should be working with Client Services". The training materials merely instruct the employee to give the consumer a courtesy call to explain to them that the employee is no longer handling the account and to provide CO-2 phone number to the consumer for assistance. This training document did not mention or discuss any actions associated with additional counseling. It dealt exclusively with DMP enrollment matters. Due to sales goals and compensation

based on amount of sales, employees did not want and neither were they encouraged by management to spend their time talking to a consumer who no longer had the potential to boost their compensation. If they did return the consumer's call it was primarily to tell them to call CO-2.

Based on the content of the script, testimonies provided by employees, and the method by which ORG compensated its employees, and the threat of termination for low sales quota, employees were placed in an environment which was not conducive to provide education but instead created a sales environment geared towards the sale of debt management plans.

Fees/Contributions. In the Form 1023 Application, ORG indicated that "Clients will be requested to pay periodic fees to ORG to receive the budget plan service. The fees will consist of \$ per creditor per month up to a maximum monthly fee of \$ per client. **These fees will be reduced or waived for any client who is financially unable to pay the full amounts.**" [emphasis added]. ORG further stated that "The fees will be reduced or waived for indigent clients. No client will be denied budget plan service due to an inability to pay any fees."

The 1023 Application also stated that "ORG also anticipates receiving substantial contributions from clients. ORG will ask clients to help defray the costs of its counseling and budget plan costs through a payment of 2 1/2% of their outstanding indebtedness." A copy of the template copy of the consumer agreement submitted with the 1023 application package stated the following "I understand that ORG does not charge any "advance fees" for any of their programs, but I understand that I have been requested and voluntarily agree to make a one time non-refundable "counseling" contribution to ORG equivalent to 3% of the total debt that they are handling for me. This contribution is approximately equal to one of my payments on the debt management program and will be procured from my first payment." "I have also been requested and agree to make a voluntary "monthly" contribution of \$ per account that ORG is handling for me."

ORG submitted copies of debt management agreements that were used in the debt management process. The following standard language was used in ORG Debt Management Agreement "I understand that ORG does not charge any required "advance fees" for any of their programs, but I understand that I have been requested and voluntarily agree to make a one time non-refundable "counseling" contribution to ORG equivalent one payment on the debt management program that will be procured from my first payment. I understand that the "counseling" contribution will be used to cover the operational costs involved in setting up my account and negotiating with my creditors. I further understand that in addition to the one time "counseling" contribution. I have also been requested and agree to make a voluntary "monthly" contribution of \$ per account that ORG is handling for me. These funds will be used to cover the costs involved in handling my creditors on a monthly basis." It appears that the language submitted in the 1023 Application was the language that was used during the examination years since it is substantially similar to another template provided in the training materials. See Exhibit 49 for template copy of ORG Debt Management Agreement

In practice, it appears that ORG was consistent in charging all consumers a monthly fee of \$ per account up to a maximum of \$ monthly. ORG also consistently charged a "one time non-refundable "counseling contribution" equivalent to approximately 3% of the consumer's total debt.

In practice, ORG did not attempt to identify those persons who could be classified as indigent. The debt management program was made available to anyone who was interested in the program and met certain criteria such as a) living in a State in which ORG is permitted to conduct business, and b) have a certain amount of debt i.e., \$.

Question 34 of the questionnaire asked what did employees tell a consumer who could not or was unwilling to give a contribution. Per EMP-14 questionnaire response (see Exhibit 42), he indicated that "We explained that there was a cost of doing debt counseling and that it paid to keep the lights on." Per EMP-13, Sales Manager (see Exhibit 41) "You would have to try and talk them into it. If you couldn't you still could help them enroll in the plan." Question 35 of the questionnaire asked if it was a requirement to obtain the supervisor's signature for consumers who did not pay the "voluntary" contribution and/ or monthly fee or reduce fee. EMP-13 response indicates that that it was a requirement to obtain the supervisor's signature to waive or reduced the voluntary contribution.

The rebuttal script response regarding consumers refusal to contribute demonstrates that ORG requested fees from everyone and used language to pressure them into contribute when they refused. Based on the manner in which ORG solicited the "contribution", it cannot be called a contribution but an administrative fee charged for participation in the debt management program.

The first payment charged by ORG to its clients was based on that particular client's total amount of debt. Therefore, an individual with one credit card who had an extremely large amount of debt would pay a higher first payment than an individual with multiple accounts with a smaller amount of debt. Thus, the first payment amount charged by ORG bears no correlation to the actual cost to establish the customer on the debt management program.

Question 36 of the questionnaire asked about the procedures used to determine if the consumer was indigent/poor and could not afford the payment before the employee asked for a contribution. In response EMP-14 (see Exhibit 42) indicated that such determination as not made. EMP-13, the supervisor (see Exhibit 41), also indicated that no verification of indigence was made.

ORG did not limit its debt management program to a charitable class. It had no established procedure or policy in place that would allow for a waiver or reduction of the first payment or monthly fee. ORG had no policy or guideline in place to waive the fee for individuals or families to whom the payment would cause financial hardship. ORG's debt management program was not designed to distinguish between the indigents, non-indigents or low-income individuals or families. The organization erected obstacles to prevent or minimize any reduction or waiver of first payment or monthly fees. Such policy includes the requirement that reduction of contributions be approved by the manager, and using a compensation package based on the number of enrollees and total contribution. Based on the manner in which the program was administered, the debt management plan did not serve a charitable purpose.

Website/Welcome Package/Referrals/CO-2. The organization's website during 20XX thru 20XX had information regarding its debt management program with little or no educational items. It was not a practice of ORG employees to refer consumers to its website to read educational materials because such materials did not exist.

The Welcome Package had items which were directly or indirectly related to the debt management program. A detailed review of the Welcome Package showed that most if not all of the information was follow-up information for those who enrolled in the debt management program. Such information includes a two page document of reminders for consumers enrolled in DMP; DMP; list of creditors for consumers to call to change payment due dates; payment envelopes; and instructions to call CO-2 with future questions (see Exhibit 46 contains the Welcome Package documents).

Overall, substantially all information in the Welcome Package relates to DMP matters. Payment envelopes, important reminders about the DMP plan, and EFT authorization forms do not serve to educate consumers on sound money management. Thus, the Welcome Package was not used primarily as an educational tool.

ORG referral process was not an educational credit counseling service. ORG merely pointed the consumer to another company which could provide some other form of financial assistance for a fee. The primary purpose for most of the referrals was to allow consumers to obtain loans to pay off their debt.

The back office services provided by CO-2 served as the customer service unit to respond to clients inquiries regarding matters relating to the debt management plan. Clients would contact CO-2 if they felt their statement was incorrect or if creditors continued to contact them after they have been enrolled in a debt management plan. The CO-2 contract specifically excludes intake and counseling service. CO-2 involvement with the clients after enrollment in the program was an extension of the debt management service and did not serve an educational purpose.

Use of Resources.

According to the Form 990, ORG's total expenditures for 20XX were \$. At a minimum, looking at two expense categories that were clearly identifiable as expenses associated with the DMP process - 1) leads/advertising, and 2) CO-2-back-office - the following was noted.

Expense	20XX Expenses	% of Total Expenses
Leads/Advertising		
CO-2-Backoffice		
Total		
Total F990 Expenses		

Excluding any payroll expenses, the annual average amount of ORG's overall expenditures on the DMP process represent 66% of its total expense for 20XX.

ORG's debt management program is the primary activity of the organization since a substantial amount of its resources were devoted to the program and represent a significant percent of its overall operating cost. ORG does not further any charitable or educational purpose when it mass markets a DMP.

Although the representations contained in ORG's Form 1023 Application package portrayed ORG as an organization substantially similar to the organization described in Revenue Ruling 69-441 and the CO-29 case ("CO-29"), its actual operations/activities were not consistent with the activities described in the revenue ruling or in the CO-29 case. ORG did not provide community education or counseling assistance similar to that described in the revenue ruling or the CO-29 case. Based on the daily duties of the employees, substantially all of the ORG employees' time was spent on the debt management program, as contrasted with the CO-29 case where the DMP activity was a relatively small part of that organization's activities. Moreover, in that case, the organization charged "nominal" fees, received some public support and had a board dominated by members of the general public, factors indicating a charitable operation.

In addition to the lack of educational or charitable activities, ORG has a substantial non-exempt purpose of selling a product, the DMP, and providing business to CO-2 and its successor entities.

Discussion – Control of ORG by President and EMP-1

Exemption from tax under section 501(c)(3) is necessary in order for fair share monies to be paid by creditors to credit counseling organizations, as well as to avoid Federal Trade Commission scrutiny under the Credit Repair Organizations Act, which was enacted September 30, 19XX, and became effective on April 1, 19XX. This Act specifically excludes any nonprofit organization that is exempt from taxation under section 501(c)(3) of the Internal Revenue Code (see a summary of the CROA law in Exhibit 57). Hence, securing tax-exempt status under section 501(c)(3) was critical to all organizations' economic viability as a credit counseling organization and assisted in ensuring that it could operate in a more unfettered manner.

Once CO-1 could no longer handle all its leads and his wholly-owned back office company CO-3 was operating as a separate entity, President ordered individuals within CO-1 to assist in CO-16t up operations of other credit counseling agencies (CO-26), all of which entered into fulfillment agreements with CO-3. Depositions from EMP-4 (EMP-4), former CO-1 employee who assisted in distributions of leads to CO-1 and CO-3 clients CO-26, clearly indicate that President was controlling the operations of the CO-26 (see Exhibit 58 EMP-4 (EMP-4 Deposition)). See also Exhibit 8, page 181, EMP-3 deposition dated 1/6/05 for discussion on distribution of leads to other CO-26.

Excess leads, according to the deposition of EMP-4 (EMP-4) (see Exhibit 58), were distributed to the CO-3 contracted CO-26 such as ORG.⁶ Those CO-26, including ORG, all contracted with CO-3, President's wholly-owned company, to process the client payments resulting from individuals entering into a debt management plan.

The fees paid by ORG to CO-3 in 20XX under the Fulfillment Agreement were not reasonable in relation to the industry. The analysis of CO-2's financial statements and tax returns show that it was "super-profitable" compared to industry norms. This was due exclusively to the lack of arms-length

⁶ There are no written contracts with CO-1, the friends of President and the former employees of CO-1 or CO-3 for lead purchases.

negotiations between ORG and CO-3 resulting from President controlling both entities either directly or through nominees.

EMP-1 claimed that his brother President was not involved in the idea to form ORG. However, as discussed previously, EMP-1 received a loan from a company owned by President to fund ORG operations. In addition, EMP-1 in his interview stated that ORG operations were the same of CO-1 being that they used the same contracts, forms, scripts, and same lead generation companies.

Attorney was the incorporator of ORG. Attorney is a close friend and business associate of President. According to EMP-1, Attorney helped him setup ORG' governance and board. Attorney prepared the application, the Articles of Incorporation, and the By-Laws. Attorney used estimates for the budget and gave him guidelines and the business model to follow. (see Exhibit 18 for EMP-1 interview).

Similar to what he had done with other credit counseling agencies, President provided ORG with financial assistance and leads to assist ORG (see EMP-1 testimony in Exhibit 18).

Further evidence of the overcharging is found in EMP-3's testimony (see Exhibit 9). Also, the US Bankruptcy Court Examiner concluded that he found a vendor who can currently service the CO-1's DMPs at a cost much cheaper than the current arrangement with CO-2 (see Exhibit 7). EMP-20's memo on CO-1 Processing (see Exhibit 59 for the EMP-20 Memo taken from the files) even states that the 20XX cost (with substantial portions of the cost attributable to corporate "overhead") is \$ per DMP per month, far less than the initial \$ a month that CO-1, ORG and other CO-3 contracted CO-26 were charged by CO-3.

Due to a 19XX criminal conviction in State on money laundering, President used nominees in order not to draw scrutiny on his companies (see the Court documents in Exhibit 60). President installed EMP-1 into ORG to control its operations and immediately enter into a Fulfillment Agreement with CO-3 for substantial fees for back office services.

President also controlled the leads through the coordination of advertising and lead inventories. President put a former CO-1 employee, EMP-4, into her business, CO-7, in order to consolidate and distribute leads generated from CO-1 advertising to CO-3 clients (and subsequently advertising for other spin-off CO-26). EMP-4 contracted with advertising media for CO-1 and sold the resulting leads to CO-1, CO-3, ORG, and other CO-1 spin-offs that were CO-3 clients. Also, see Exhibits 8 & 9, EMP-3 deposition and Exhibit 58 EMP-4 Deposition.

Notes to the financial statements for CO-2 for December 20XX and 20XX, note J, related party transactions stated the following: A key employee of the Company owns CO-27, Inc. ("CO-27"), an entity that provides leads to non-profit debt counseling organizations. The company purchases leads from CO-27 and provides them to clients as form of marketing, which is recorded to advertising and lead support." (See Exhibit 62 for copy of financial statement). Monies for leads provided to ORG and other organizations were invoiced and collected by CO-3 (see copies of CO-3 invoices and spreadsheets in Exhibit 51 & 61)

A further exhibit proving that President and CO-2 controlled ORG and other CO-3 client CO-26 is found in the data that CO-3 collected on the CO-26. CO-2 had substantial lead cost information as

well as profitability analysis (see the EMP-20/CO-2 memo in Exhibit 59, the CO-3 accounts receivable and revenue analyses in Exhibit 61 which contains information on all CO-3 controlled CO-26 and the Bears Stearns CO-2 Sale in Exhibit 63. President responded to the FTC (see Exhibit 64) showing all of the relationships to the CO-3 client CO-26. (See the Senate Report (CO-3 comments in the Senate Report in Exhibit 6) which contends that the "CO-2-CO-2" conglomerate is controlled by the CO-3 business practices and President.

President was able to direct the resources and personnel of CO-1 to CO-16t ORG. President directed CO-1 to provide forms, agreements, management assistance, training, and personnel to ORG which he CO-16 with trusted, former employees of CO-1, his brother EMP-1. Virtually all of these CO-1 spin off companies were represented during the exemption application process by Attorney who also represented CO-1. President also assisted them with loans and leads to CO-16t the companies in exchange for them signing Fulfillment Agreements with his company, CO-3. The memo discusses this business model that was employed by CO-3 (see Exhibit 63). Also, the CO-3 financial statements for 20XX and 20XX state that the business model is to assist CO-26 who are clients with advertising and marketing (i.e. leads) (see Exhibit 62).

The fulfillment agreements fees were not negotiated at arms-length and as a result, substantial monies inured to the benefit of President. According to an IRS Engineering Report on the value of the back-office services, CO-3 substantially overcharged ORG for the services provided (see IRS Engineering Report in Exhibit 52).

Discussion: Inurement and Private Benefit to CO-2 and President

As stated previously, ORG signed a Fulfillment Agreement with CO-2, a company wholly owned by President, upon formulation of ORG. EMP-1 in his interview indicated that no due diligence was done prior to signing the contract with CO-2.

The IRS Engineering Report concludes that CO-3 is "super profitable" by industry standards and over-charged ORG in processing fees under the Fulfillment Agreement in 20XX in the amount of \$ (see analysis in Exhibit 52). Like the situations in the cases of est of Hawaii and International Postgraduate Medical Foundation, *supra*, President's for-profit entity, CO-3, benefited substantially from the operation of ORG and other CO-26. The evidence in this case establishes that the substantial purpose of ORG was to increase the income of CO-3.

CONCLUSION

ORG did not operate exclusively for educational or for any other exempt purposes within the meaning of section 501(c)(3) of the Code since its primary activity was the sale of debt management plans. ORG conducted no educational activities within the community, provided no educational training or counseling to individuals on credit or debt management issues, and did not provide education in the context of sales of its debt management plans. The debt management program was not limited to a charitable class and ORG did not have an established policy or procedure to waive or reduce the fees for the indigents or to waive the fees for those to whom such fees would create financial hardship. Consequently, it does not serve a charitable purpose. Since ORG's primary

activity was the sale of debt management plans which lacked substantial educational or charitable aspects, its exemption under section 501(c)(3) of the Code should be revoked effective April 19, 20XX, the date of its formation.

In addition, ORG had a substantial non exempt purpose in selling a product, the DMP, and providing business to CO-2 under a contract that was extremely lucrative to CO-2. ORG did not further any charitable or educational purpose when it marketed its DMPs. Moreover, because ORG as a section 501(c)(3) organization was exempted from the CROA, it was able to engage in deceptive business practices that Congress intended to prohibit when it passed the CROA law. As such, ORG is operated for a substantial non-exempt purpose that of carrying on a business while avoiding federal regulation.

ORG earnings also inured to the benefit of CO-2 and its founder (and the founder of CO-1), President. ORG paid fees to President's company CO-3, in 20XX that were \$ in excess of reasonable, fair market value. Since ORG earnings inured to the benefit of President and his company CO-2, its exemption under section 501(c)(3) of the Code should be revoked effective April 19, 20XX the date of its formation. Furthermore, even without considering inurement, ORG was operated primarily for the benefit of CO-2

ORG conferred private benefit to President's for-profit business, CO-2. Since ORG substantially served the private interest of President in contravention of section 501(c)(3) of the Code, its exemption under section 501(c)(3) of the Code should be revoked effective April 19, 20XX.